Evaluation of the Benefits and Risks of a State-Chartered, Public Cooperative Bank – Status Report

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However, it is emphasized that the discussion, analysis and views in this status report are solely those of the authors.

Executive Summary

Laws of 2018, ch. 299 § 129(17) RCW, the supplemental operating budget for 2017–18, appropriated funds for the Office of Financial Management to contract with an entity or entities with expertise in public finance and commercial and public banking to evaluate the benefits and risks of establishing and operating a state-chartered, public cooperative bank whose members would be the state and its political subdivisions, and to develop a business plan. (The full text of the budget proviso is in Appendix E.)

The budget language stated that the purpose of such a bank would be "to assist the potential members of the bank to manage cash and investments … and to establish a sustainable funding source of ready capital for infrastructure and economic development."

In late June 2018, OFM contracted with the Daniel J. Evans School of Public Policy and Governance at the University of Washington to complete this evaluation. Two Evans School faculty members — Affiliate Associate Professor William Longbrake and Endowed Professor and Associate Dean Justin Marlowe — served as co-principal investigators.

This report is focused on the first half of the budget mandate: an evaluation of the benefits and risks of establishing a state-chartered, public cooperative bank. The findings presented in this status report are intended to inform the creation of a business plan for such a bank, subject to any additional guidance from the Legislature.

The report is organized in two main parts. In the first part, we describe the potential benefits to state and local public agencies of a public cooperative bank, with emphasis on the wide variety of ways such a bank could help broaden access to capital and improve the overall financial management of cities, counties, utility districts, state government agencies and other public-sector entities. That discussion is organized around the products and services a public cooperative bank might offer, such as short-term lending to support cash flow management, long-term lending to support infrastructure investment, depository services, investment advisory services and other potential services. That discussion is based on a comprehensive review of studies of public banking. As discussed in the report, we did not focus on a publicly owned institution engaged in commercial banking functions both because that was not within the mandate of the budget proviso and because of the substantial state constitutional and federal regulatory constraints on that type of entity in Washington.

We amplify the discussion by describing the wide variety of state-level programs across the country that are designed to broaden public agencies' access to the capital markets and bolster their overall financial health. Those state-level programs include bond banks, bond pooling programs, state intercept programs and many others. State and local public agencies in Washington currently have access to several of those products and services through 80 separate programs administered by the state agencies and the State Treasurer. In concept, a public cooperative financial institution could offer some, many or all these products and services.

This discussion is followed by an original empirical analysis of state and local agencies' demand for the products and services a public cooperative bank might offer. To assess that demand we

distributed a survey to all 298 cities, 39 counties, 28 public utility districts and 180 sewer/water districts in Washington. A total of 100 (or 18 percent) of these jurisdictions responded.

Survey responses indicated that a plurality of state and local public agencies is uncertain whether they would benefit from public cooperative banking. On the question "Considering the services that a public cooperative bank might offer, do you think your jurisdiction/agency might have an interest in membership?" 32 percent said "yes," 22 percent said "no" and 46 percent said "unsure." However, many of those who said "unsure" expressed that they were satisfied with the services currently available through the state government, banks and credit unions.

However, survey responses indicated that local governments are interested, in varying degrees, in specific products and services where a public cooperative bank could address an unmet need, especially for smaller, rural jurisdictions. These include:

- A modest but consistent group of small, rural-located local governments would like better access to infrastructure financing programs. For instance, 37 percent said they'd be "Very Likely" or "Somewhat Likely" to use a bond pooling program, a pre-development loan program (22 percent), an interim loan program (16 percent) or a lease purchase finance program (13 percent). Several other states offer these types of programs, and their experience is instructive.
- A separate group of jurisdictions of all sizes is interested in financial advisory services (28 percent) or technical advisory services (28 percent) when accessing the capital markets. Most of these jurisdictions were slightly larger and more likely than most other jurisdictions to issue municipal bonds to finance capital improvements and infrastructure projects.
- The largest number of jurisdictions would like better investment options. More than 25 percent of governments said they'd like access to better options for pooled investments in money market funds, intermediate funds (23 percent) and high-interest savings funds (25 percent).

There was limited interest in cash management and depository services:

- The majority of agencies and jurisdictions shared that their current use of inter-fund loans provides them with adequate cash flow management assistance.
- While there was some interest in depository services, most agencies and jurisdictions reported that they would be unlikely or very unlikely to avail themselves of such services.

We also approached the question of demand for financial services from the perspective of commercial banks, community banks and credit unions. Through focus groups that included representatives from more than 10 financial institutions across the state, we heard repeatedly that commercial banks and credit unions believe they do, or believe they can, offer the services jurisdictions need. Banks and credit unions also raised several pointed concerns about the governance and capitalization of a public cooperative bank, and expressed deep skepticism that such an institution could be structured in a way that appropriately manages both financial and political risks. Credit unions pointed out that they've only recently had legal permission to offer depository and related commercial banking services to local governments; many credit unions plan to build out those lines of business.

The second part of this report is a discussion and analysis of potential models for a public cooperative bank capable of delivering financial products and services to state and local jurisdictions. That discussion and analysis are focused on four main issues: 1) What programs would the public cooperative bank engage in? 2) How would a public cooperative bank be capitalized? 3) What would be the source of funds for loans? and 4) What security would be provided for repaying funders?

We describe several structural models and governance mechanisms that can address these questions and examine the legal and financial risk considerations that each of those structural models and governance features presents. We find that a public cooperative bank can be legally created in Washington, but would require enacting an authorizing statute and amending various statutes.

We also find that such a bank could be structured in a way that presents minimal risk to the state's credit rating and overall financial health. The state could choose to pursue any one of those models, or, alternatively, address unmet needs with re-branded and/or re-envisioned versions of current state programs.

With respect to a federal master account and Federal Reserve Bank membership, which would enable the public cooperative bank to wire funds directly and to undertake certain other transactions without going through another financial institution that is a member of the Federal Reserve System, the public cooperative bank would either have to be eligible to obtain FDIC deposit insurance or purchase stock in a Federal Reserve bank. We found that restrictions in the Washington State Constitution (Article XII, Section 9) would probably preclude the public cooperative bank from purchasing stock in a Federal Reserve bank. While a public cooperative bank could be structured to qualify for FDIC insurance and thus be eligible for Federal Reserve membership in that way, this would require creating the public cooperative bank as a chartered private entity, which would subject it to securities and other federal financial regulatory requirements. We concluded these burdens would outweigh the benefits of Federal Reserve System membership and that the services provided by the Federal Reserve System can be easily accessed through other Federal Reserve member financial institutions.

Introduction – Why Consider Public Cooperative Banking?

In recent years and particularly since the Great Recession, some have advocated establishing publicly owned banks, arguing that they would offer taxpayers and consumers a variety of benefits, which are either not available through the private-sector banking system or could be provided by a public bank more effectively and at lower costs. In response, more than a dozen states and municipalities have studied the feasibility of publicly owned banking. More recently, interest in publicly owned banks has also been spurred by the practical need to provide banking services for the newly legalized marijuana industry in many states.

In this study we examine the benefits and risks to public governmental agencies of publicly owned banking, or, as we call it, a "public cooperative bank," whose members would be restricted to public governmental agencies. A public cooperative bank is a financial institution created by the public sector, for the public sector. It would serve cities, counties, public utility districts, port districts and state agencies. This study does not address the benefits and risks of a publicly owned bank providing banking services to consumers.

To our knowledge, no previous study has examined a cooperative model of public banking. Previous studies of public banking have examined the feasibility in different settings of a "North Dakota" style public bank that accepts deposits from consumers and provides loans to consumers, as well as provides banking services to businesses and governmental jurisdictions. The most recent study in Washington state is Seattle's feasibility analysis of a municipal bank chartered and operated by city of Seattle.[1] The model of public cooperative banking described in this report is different from public banking models considered in other studies, which would provide banking services to a broad clientele, including consumers.

Although we were not charged with studying the feasibility of a public bank that would serve consumers, many of the public banking studies also explore providing banking services to governmental jurisdictions. Accordingly, we conducted a comprehensive review of public banking studies (see Appendix A for an annotated bibliography of the studies we examined). In this report, where appropriate, we incorporate insights from those studies.

From that review, we identified three main categories of financial services a public cooperative bank could offer governments, which are analogous to the kinds of banking services a public bank might offer consumers:

1. Improved access to capital to support infrastructure investment.
2. Improved access, potentially on better terms, to support cash flow management, treasury management and other kinds of financial services.
3. Broader investment opportunities with the potential for better investment returns.

Many of these financial services are currently offered through a plethora of Washington state programs, and by private banks and credit unions. A pertinent question, which is examined in this study, is whether gaps exist that could be filled effectively by a public cooperative bank and/or by

[1] See Public Bank Feasibility Study for the City of Seattle (November 2018).

enhancements in current Washington state programs. With that question in mind, we reviewed approximately 80 Washington state infrastructure financing programs and subprograms administered by 12 state agencies. We also inventoried infrastructure financing programs that other states and municipalities provide. These reviews revealed that unfilled gaps exist.

In addition, to assess Washington state governmental jurisdictions' (cities, counties, public utility districts and water/sewer districts) satisfaction with current programs and services, with the assistance of representatives of these jurisdictions, we designed and conducted a "User Needs Survey." The objective for this survey was simple: to identify unmet financial services needs that a public cooperative bank could meet uniquely, or meet more effectively than existing programs. We also gathered qualitative data on user needs from commercial banks, community banks and credit unions. Responses provided a wealth of information about the kinds of financial services used by Washington state governmental jurisdictions and the adequacy of these services. While many needs for financial services are now being met, survey responses indicated that some gaps exist.

We also include a detailed legal feasibility analysis in this study. That analysis indicates that a public cooperative bank can be chartered by the Washington State Legislature.

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Washington State's Current Infrastructure Financing Programs

States generally rely on a network of agencies and programs to provide local governments with the support necessary to finance capital improvements.

Currently, Washington has more than 80 programs and subprograms administered by 12 agencies that provide financial support to local governments in the state.[2] While the state offers more programs and funding opportunities than most, the collection of programs was not designed to operate as a system. This has led to inefficiencies and resulted in program underutilization. Recognizing synergies within programs, agencies are also now required to better coordinate funding of projects (e.g., SYNC program).[3]

While there are more than 80 programs and subprograms in the state that provide financial support to local governments, we provide a brief review of nine programs that provide access to capital to finance infrastructure investments (specifically roads, railway, clean water, wastewater, stormwater and affordable housing). These programs provide eligible local governments and public agencies access to low-interest loans and grants (agencies that provide only grants are excluded). Interest costs on loans are far below current market rates (0.5 percent up to 3 percent), and borrowers incur minimal or no transaction costs. The challenge facing agencies that provide financial support to eligible local governments is their ability to provide adequate funding to meet demand. Since the Great Recession, the state has either reduced funding or its current commitments fall far short of demand for grants and loans.[4]

The Public Works Assistance Account, also known as the Public Works Trust Program, provides planning, pre-construction, construction and emergency loans for local infrastructure improvements. The program is administered by the Public Works Board. Eligible activities include repair, replacement, rehabilitation, reconstruction or improvement of water, sewer, storm, road, bridge, and solid waste/recycling public works systems. Eligible governments are counties, cities, towns, and water and sewer special purpose districts. Ports and school districts are ineligible.

Of the programs that loan funds to local governments in the state, the Public Works Trust Program is the largest and most visible of all funding mechanisms. Initially established with appropriated bond proceeds, its primary source of revenues, prior to the Great Recession, were loan repayments, state appropriations and revenues from the real estate excise tax, public utility tax and solid waste

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[2] See Infrastructure and Public Depository Task Force Final Report (December, 2017). The Office of the State Treasurer has a resource, in the final stages of development, that compiles the state's programs into a single, user-friendly site, making it easier to locate sources of funding. Users will have the ability to search this database containing more than 130 available programs (and growing), either by project type or by keyword, to find a funding source that fits their specific needs. The Washington Fund Directory will be launched by the end of the 2018.

[3] SYNC is a system improvement team was created by the Legislature in HB 1677 to "identify, implement, and report on improvements" to the water/wastewater/stormwater funding programs to maximize their value. The Public Works Board, along with the departments of Commerce, Ecology and Health, is synchronizing its efforts to create a more efficient structure for infrastructure financing programs.

[4] For a more extensive list of programs, see Office of Program Research summary of Existing Washington State Infrastructure Financing Programs Appropriated in the 2015-2017 Capital and Transportation Budget. For a more extensive review of public infrastructure programs in the state, see Inventory and Evaluation of the State's Public Infrastructure Programs and Restructuring State Public Infrastructure Programs.

tax. That mix of revenues has changed dramatically with the diversion of revenues from REET and erosion of capital with multiple transfers to the state's General Fund and Education Legacy Account. Figure 1 shows how much money has been diverted or transferred to the Public Works Program between 1993 and 2019 by the source of funding. Figure 2 shows how much money has been diverted or transferred to the Public Works Program between 1993 and 2019 by the amount of funding.

Figure 1: Public Works Trust Program Diverted/Transferred Funds (1993-2019)[5]

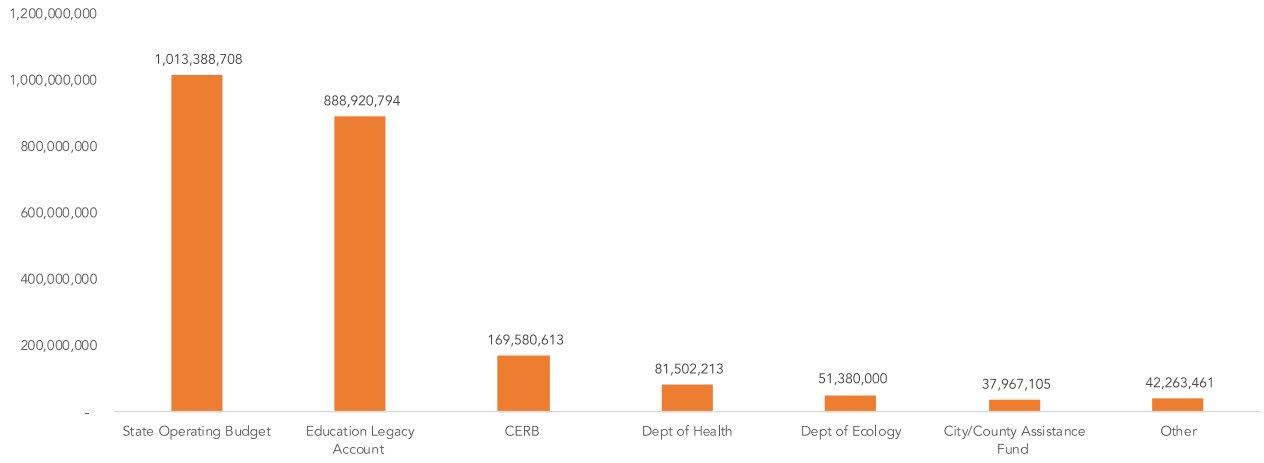
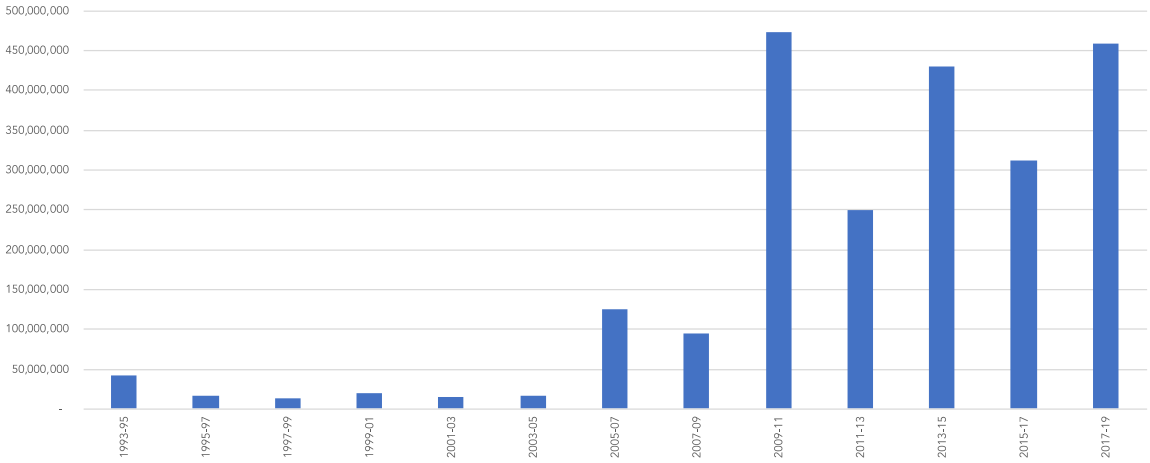


Figure 2: Public Works Trust Program Diverted/Transferred Funds (1993-2019)[6]

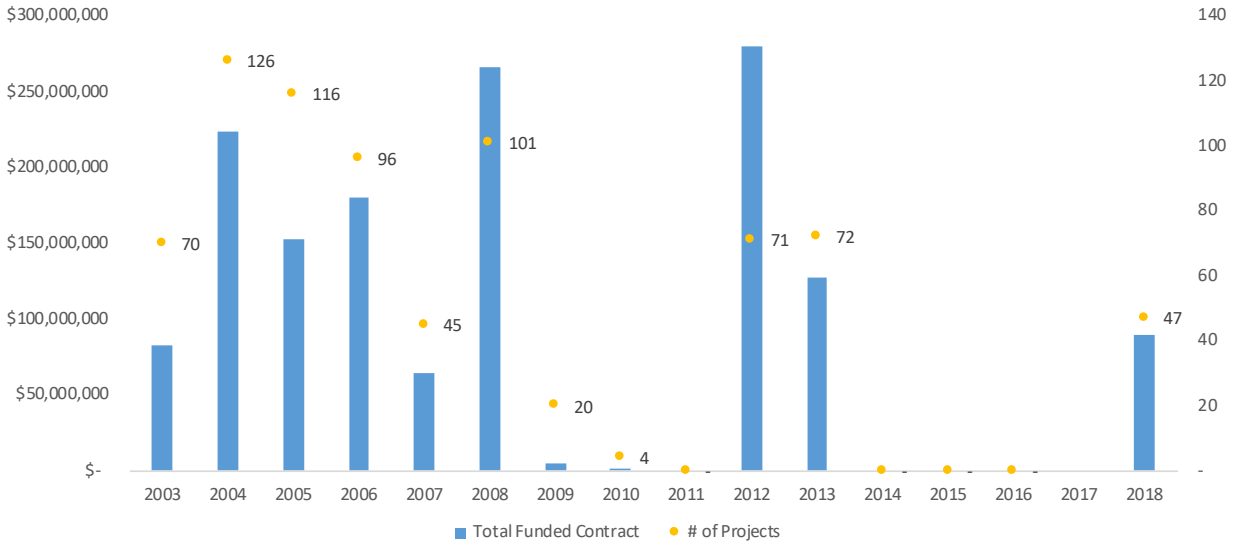


[5] Source: Department of Commerce
[6] Source: Department of Commerce

The Legislature continues to fund the agency with biennial appropriations. However, funding levels have been significantly lower than they were before the recession. This has significantly hampered the agency's ability to loan funds. In 2008, the agency funded 101 projects ($265 million). In 2009 and 2010, it funded 24 projects ($5.8 million). There have been gaps in funding since the recession. The Public Works Trust Program did not fund any projects in 2011, 2014, 2015, 2016 and 2017. In 2018, it funded 47 projects. Figure 3 shows by year the amount of funds and number of projects by the Public Works Trust Fund between 2003 and 2018

To meet current commitments, the Legislature has had to appropriate proceeds from recent bond issues.[7] The Legislature has also continued to fund the agency via the appropriation process.[8] As a result, the number and value of funded projects approved by the Public Works Board are a fraction of what they were in prior to the Great Recession.

Figure 3: Public Works Trust Fund Loans and Projects (2003-2018)[9]



The Water Pollution Control Revolving Loan Fund provides low-interest loans for planning, design, acquisition and construction of water pollution control facilities and nonpoint source pollution control activities. The Department of Ecology administers three major funding programs under the Combined Water Quality Financial Assistance Program: the Stormwater Financial Assistance Program, the Centennial Clean Water Program and the federal Clean Water Act Section 319 program. Grants and loans are awarded to high-priority water quality projects on a competitive basis.

[7] To fund current commitments, the state appropriated $195 million in the 2009–11 biennium and $148 million in the 2013–15 biennium. To fund approved loans, the state appropriated $116 million in the 2017-–19 biennium. Data provided by the Department of Commerce.
[8] Appropriations were $137 million in 2007–09 and $453.4 million in 2011–13. Data provided by the Department of Commerce.
[9] Source: Department of Commerce

In the 2017–19 biennium, the Department of Ecology is expected to fund $115 million in low-interest loans via the Clean Water State Revolving Fund, $26.8 million in the Stormwater Financial Assistance Program, $12.1 million in Centennial Grants and $1.5 million in Clean Water Act 319 Grants, for a total of $155 million.[10] The Clean Water State Revolving Fund will meet its $115 million loan commitment using $28 million in federal funds, $5.6 million in state-match funds and interest earnings and loan repayments to the fund itself.

Demand for funds far exceeds the Department of Ecology's capacity to provide financial assistance. In the most recent funding cycle, the agency received $421 million in funding requests and is expected to provide $155 million in funding (or 37 percent of requests).

While Washington's Clean Water State Revolving Fund was initially capitalized with bond proceeds, the agency does not issue municipal bonds. On the other hand, more than half the states have clean water or drinking water revolving funds with bonding authority.[11]

The Drinking Water State Revolving Fund provides low-interest loans for public water systems to publicly owned (municipal) and privately owned drinking water systems statewide. The loan program is funded through federal and state money and subject to state laws and additional federal regulations. The loans to privately owned systems are from federal funds. The program is jointly administered by the Department of Commerce and Department of Health.

The state is expected to receive $24.815 million in federal funds for the 2017–19 biennium. The state is required to match federal funds. Current year match funds were $5 million.[12]

Demand for funds far exceeds the agency's capacity to provide financial assistance. In 2017, the agency funded $12 million in loans and approved an additional $21 million in loans that remain unfunded.[13]

The Community Economic Revitalization Board provides loans and grants to finance public infrastructure improvements that encourage new business development and expansion in areas seeking economic growth. Eligible projects include bridges, roads, domestic and industrial water, sanitary water and storm sewers, earth stabilization, electricity, natural gas, telecommunications, general purpose industrial buildings, port facilities, etc. Eligible applicants are counties, cities, towns, special purpose districts, federally recognized Indian tribes, and municipal and quasi-municipal corporations with an economic development purpose.

The Community Economic Revitalization Board has committed $163 million in project funding since its inception in 1982. The board's investment has generated an additional $385 million in public funds and $5.6 billion in private capital investment (the program requires matching funds on approved projects).[14]

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[10] See State Fiscal Year 2019 Final Water Quality Funding Offer List and Intended Use Plan (May 2018) report prepared by the Department of Ecology.
[11] See Moody's (2013) "Rating Methodology: U.S. State Revolving Fund Debt."
[12] See Washington State Drinking Water State Revolving Fund (July 2018) report prepared by the Department of Health – Office of Drinking Water.
[13] See Drinking Water State Revolving Fund 2017 Loan List.
[14] See Department of Commerce – Community Economic Revitalization Board webpage.

The Community Economic Revitalization Board and the Department of Revenue are authorized to administer the Local Infrastructure Financing Tool program. LIFT allows local governments to use locally imposed taxes generated by private business activities within a designated revenue development area to help finance public infrastructure improvements (akin to a tax increment financing district). These local taxes are treated as a credit against comparable state taxes, so there is no net impact on affected taxpayers. Nine jurisdictions now participate in LIFT, each eligible to receive a state contribution of up to $1 million per year for 25 years. Allocation of local authority to collect the LIFT taxes is determined by the Department of Revenue based on local progress reports. The state had allowed for $34 million in funds to be collected by these governments since 2010.[15]

The Housing Trust Fund provides loans and grants for construction, acquisition and rehabilitation of low-income multi-family and single-family housing. Eligible agencies include local or regional housing authorities, nonprofit community or neighborhood-based organizations, federally recognized Indian tribes, and regional or statewide housing assistance organizations. The program provides low-interest loans (no more than 2 percent) with maturities that exceed 25 years but no more than 40 years.

Since eligible entities are required to provide match funds, the program has been able to scale up its level of investment (average match requirement of 20 percent). Sources of match funds include public sector programs (federal and local) and private sector organizations (developers and private banks).

The fund received $110.8 in state funding for the 2017-19 biennium.[16] Together with the federal HOME program, the National Housing Trust Fund and the Disaster Displacement funds, the agency has the authority to obligate $123 million in loans and grants.

While the program is administered by the Department of Commerce, there are complementary programs administered by the Washington State Housing Finance Commission. The commission is a self-supporting agency of the state. The commission has the authority to issue municipal bonds, the proceeds of which can be used to finance housing projects (single-family and multi-family projects). Because the agency issues revenue bonds, its obligations are not of the state, but rather obligations of eligible agencies that rely on the commission to serve as a conduit to the capital market. Of the state agencies charged with financing infrastructure, the commission is the only agency authorized to issue municipal bonds.[17]

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[15] The nine governments are the cities of Bellingham, Bothell, Everett, Federal Way, Mount Vernon, Puyallup, Vancouver and Yakima, and Spokane County (cities of Mount Vernon and Vancouver have yet to implement their LIFT programs). See Local Infrastructure Financing Tool Program 2018 Biennial Report.

[16] See Department of Commerce June 2018 report on the Washington State Housing Trust Fund, HOME, and National Housing Trust Fund programs.

[17] Bonds issued to finance transportation investments are not issued by the Washington State Department of Transportation, but rather the OST. The state has pledged its full faith and credit to its motor vehicle fuel and toll backed bonds (frequently referred to as motor vehicle fuel tax general obligation bonds). As a result, the state has more general obligation (or full faith and credit) debt outstanding ($21.3 billion or 80 percent of all bonded obligations) relative to peer governments. See State of Washington 2018 Comprehensive Annual Financial Report and State of Washington Debt Affordability Study.

The Freight Rail Investment Bank provides low-interest loans while the **Freight Rail Assistance Program** provides grants, on a competitive basis, to publicly owned railroads, port districts, rail districts and local governments. Relative to the current programs, the Freight Rail Investment Bank and Freight Rail Assistance Program are small and provide only supplementary support (a 20 percent match is required for all projects).

The Freight Rail Investment Bank was originally authorized in the 2007 transportation budget. The two programs have since received additional funding following the approval of the Connecting Washington transportation package in 2015. The program is administered by the Department of Transportation's Rail Capital Program.

For the 2019–21 biennium, a total of $8.3 million is available for Freight Rail Assistance Program grants and $7.1 million for Freight Rail Investment Bank loans.[18] Both programs receive funding from a variety of sources, including revenues from sales taxes on the purchase of the vehicles, rental vehicles, and certain license and permit fees and budget appropriations.

The Transportation State Infrastructure Bank provides low-interest loans for transportation and infrastructure projects. State infrastructure banks were originally authorized by the National Highway System Designation Act of 1995. Any entity that receives federal highway funds is eligible to apply for state infrastructure bank loans. The state's infrastructure bank program has received limited funding ($1.7 million in the 2015–17 biennium) and has provided nominal financial support to date.

These seven programs rely on biennial appropriations through a variety of fund sources (e.g., Public Works Trust Fund) to fund their loan and grant programs. These agencies do not provide eligible local governments with access to capital via the municipal bond market.

Two programs provide local governments with access to capital via the municipal bond market. These programs are administered by the Office of the State Treasurer:

- The LOCAL Program offers a cost-effective way for Washington municipalities to finance essential real estate and equipment as either a financing contract or lease (also known as certificate of participation).[19] While these certificates are issued by the state, the state's obligation is limited to the extent that the state is an obligor in the certificates;[20] otherwise local governments participating in a specific contract are named as the obligor. If a local agency were to default on its obligations, the State Treasurer is authorized to make payments on behalf of the local government participating in the program. The Treasurer will initiate procedures to recover funds from the local governments, primarily by withholding state-aid to that local government.[21]

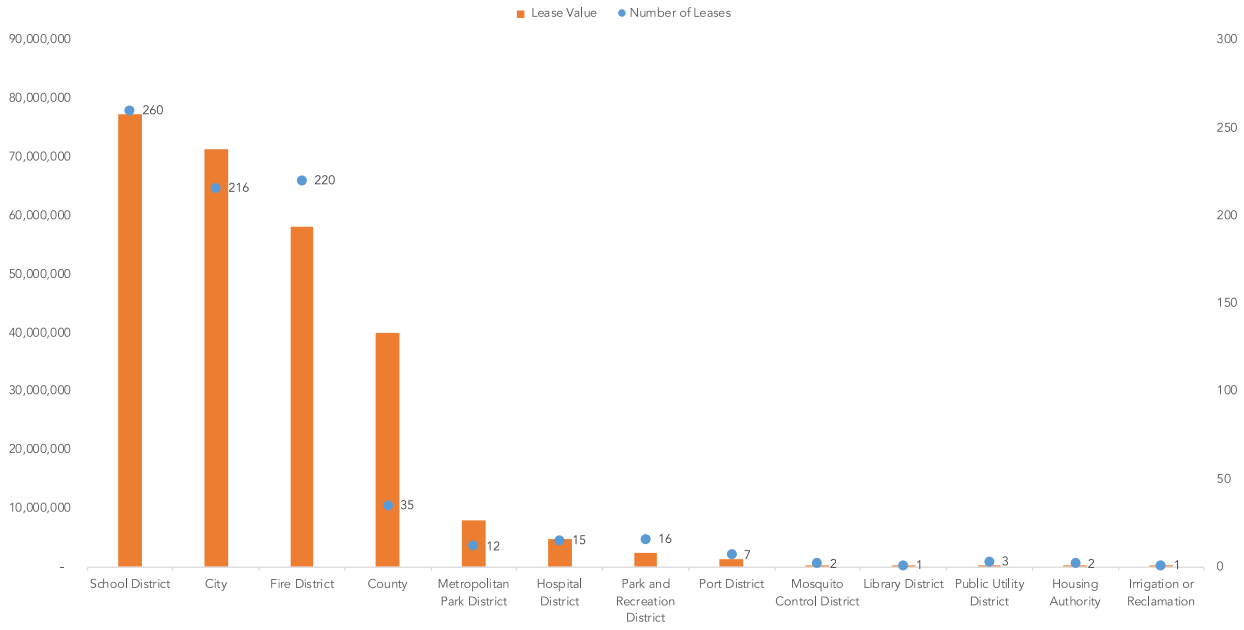
[18] See 2019–21 Freight Rail Assistance Program/Freight Rail Investment Bank Project Lists prepared by the Washington Department of Transportation (November2018).
[19] See Office of State Treasurer's presentation to the Puget Sound Finance Officers Association.
[20] When issuing certificates of participation, the state does not extend its full-faith and credit pledge. Instead these certificates are generally payable from annual appropriations by the Legislature. Furthermore, because certificates of participation are in the form of a lease, they do not count toward the state's debt limit.
[21] While the state does not have a formal Intercept program, statutes and regulations allow the Treasurer to recover funds using a similar mechanism.

- Pooling with the state's certificate of participation allows participants to take advantage of the state's very low tax-exempt financing rates because the state has a higher bond rating (a measure of credit worthiness that influences interest rates) than most local governments.[22] However, participation in the program is limited to participants that have a general obligation pledge and the ability to levy property taxes. As a result, the program has largely excluded municipalities that do not have a general obligation pledge (e.g., utility districts).
- Since 1999, the program has supported 790 projects with $264 million in certificate of participation issues. Figure 4 shows the number of projects and the dollar value of the leases for those projects from 2000 through 2018.[23] The most frequent users of the program have been school districts (260 leases, $77.3 million par value), city and county governments (216 leases, $71.4 million par value and 35 leases and $40 million par value, respectively) and fire districts (220 leases, $58.1 million par value). Local governments with commercial and other vehicle financing needs (especially school and fire districts) have benefited the most from this program (436 vehicle and truck leases). Real estate financing over the same period was limited (88 leases).

[22] The state of Washington has maintained its rating of AA+ (from Standard and Poor's and Fitch rating agency) and Aa1 (from Moody's Investor Services) for more than a decade. The state's rating is one notch below the highest possible credit rating of AAA/Aaa.

[23] Includes COP refunding issues. Data from the Treasurer.

Figure 4: The LOCAL Program (2000-2018)[24]



The School Bond Guarantee Program was established in 1999, following a voter-approved constitutional amendment. School districts must apply to the State Treasurer's Office and demonstrate that their general obligation bonds were approved by voters.

The program provides a backup general obligation pledge to school district's bonds. As a result, the rating assigned by participating school districts match the state's AA+/Aa1 rating. In effect, the guarantee enhances (or strengthens) the credit rating of school districts, without creating an obligation for the state.[25] As a result, interest costs for participating school districts are lower – all else constant.

As of Nov. 1, 2018, the state has guaranteed $13.93 billion in school district general obligation bonds issued by 181 school districts. Since the program's inception, however, the state has guaranteed $24.6 billion in school district general obligation bonds.[26]

It's important to note that in the history of the program, no school district has ever defaulted on its obligations. However, in the event of a default, the Treasurer is authorized to make payments on behalf of the school district. Like in the certificates of participation program, the Treasurer also retains the right to recover any funds paid on the district's behalf as well as any interest, recovery costs, or penalties by withholding a portion of the school district's state aid.

[24] Source: Office of State Treasurer.
[25] While the guarantee does not create an obligation for the state, it creates a contingent liability that must be disclosed in the state's financial reports.
[26] Data from the Office of State Treasurer.

Because the LOCAL and School Bond Guarantee programs do not rely on appropriations, eligible governments need not wait to finance their projects based on funding availability, a factor that constrains availability of loans and grants in the other state-sponsored programs.

These programs do not, however, address the lack of access to capital at affordable rates, particularly for governments that are not eligible to participate in grant or loan programs.[27] For example, the LOCAL program provides funding for equipment leases, and to a limited extent, real estate financing. It does not provide local governments that do not have taxing authority with access to the program. Municipal governments with financing needs that exceed the LOCAL program have only the other state loan programs previously described as other sources of low-interest loans.

In the following section, we provide a brief review of financial innovations for financing infrastructure. We focused specifically on programs in use in several states, excluding untested financing innovations.

[27] For an extensive review, see Restructuring State Public Infrastructure: Analysis for the Washington Legislature, prepared by the Office of Financial Management, December 2008.

Infrastructure Financing Programs Across the United States

While Washington state provides several avenues to fund infrastructure investments, these programs fall far short of programmatic needs. In our brief review of existing programs, we found evidence that programs eligible for loans and grants remain unfunded or underfunded. There are programs that receive funding, however due to the size of the project or the timing of the loans, eligible applicants are forced to decline funding. Finally, there are those entities that are not eligible for funding and do not have access to affordable capital. These governments have limited or no access to programs or services (e.g., bond insurance) that would mitigate perceived credit risk. These jurisdictions are often geographically remote and have limited opportunity to participate in regional solutions to infrastructure problems. They have to rely on banks for financing, at rates higher than the municipal bond market.

Over the last three decades states have created programs that provide local governments and public agencies with access to capital at affordable rates. They include municipal pool programs (including state bond banks, state revolving funds, and state infrastructure banks) and credit enhancement instruments (e.g., state guarantees and state aid intercepts). Pool programs pool debt obligations secured by municipal entities and provide access to capital at affordable rates. Credit enhancement programs 'enhance' the rating of participating governments thereby lowering their borrowing costs. Together, the programs can provide local governments with access to capital at affordable rates and at minimal cost to the sponsoring government. Below we provide a brief review of these programs and summarize the benefits of programs.

State Bond Banks

State Bond Banks are designed to lower local governments' borrowing costs by pooling the bonds of local governments to achieve economies of scale. Most banks were established in the '70s and 80's. To date, there is a bond bank in 13 states including Vermont, Maine, Alaska, North Dakota, New Hampshire, Illinois, Indiana, Michigan, Oregon, New York, Idaho, California, and Mississippi.

State Bond Banks can be structured to issue general obligation bonds, revenue bonds, or both with the local government(s) providing the repayment pledge (property taxes as a general obligation pledge and net operating revenues from utility districts as a revenue pledge). Like Washington's LOCAL program, bond issues of a bond bank do not create an obligation for the state. And like Washington's School Bond Guarantee program and the LOCAL program where bonds issues are assigned the ratings of the state, bond issues of any banks are assigned the rating of the bond bank. Ratings of most bond banks are two to three notches above the local government's own rating. As a result, the local government not only benefits from lower borrowing costs from higher ratings, it benefits from economies of scale because underwriting costs, credit rating fees, and fees for financial advisory services are spread over a large bond pool participated in by many local governments.[28]

[28] See Robbins, Mark D., and Daehwan Kim. "Do State Bond Banks Have Cost Advantages for Municipal Bond Issuance?" *Public Budgeting & Finance* 23.3 (2003): 92-108.

Empirical evidence suggests local governments that issue bonds on a negotiated basis would reduce their borrowing costs by joining a bond bank. Lower rated issuers are also more likely to benefit from the services of a bond bank, all else constant. In fact, the smaller the issue and the lower the rating, the larger benefit. The only issuers that would not benefit from the services of a state bond bank are large issuers, with a high credit rating (Aa or above) that frequently issue their bonds on a competitive basis.[29]

Local governments can also obtain other advantages from participating in pooled financing programs. Program staff can provide financial advisory services at low or no cost to participating governments. State bond banks and similar programs simplify the issuance process, requiring participants to complete a few short forms.[30] They can set up payment schedules with local governments that are uncharacteristic of municipal bonds that best fit the needs of the municipality (e.g., monthly rather than semi-annual).

While most state bond banks are self-sustaining, states often provide nominal appropriations in support general operations. In some states, the state appropriations are large as the bank is home to the state's clean water and drinking water revolving funds.

State Revolving Funds

Practically every state has a water/wastewater revolving fund. Funding of water/wastewater projects originally occurred through federal grants. This funding mechanism was eliminated with the adoption of the Water Quality Act of 1987. The legislation established the state-run Clean Water State Revolving Funds that are capitalized with grants from the Environmental Protection Agency and a minimum 20 percent match of state funds. The Safe Drinking Water Act of 1996 expanded the operation of state revolving funds to drinking water with the creation of Drinking Water State Revolving Funds with a similar state match funding requirement.

Washington has revolving funds for both clean water and drinking water, but neither agency has direct bonding authority. Washington's revolving funds, like several states, elect to use these funds to make direct loans to participants. Several states have opted to issue bonds to leverage appropriated money from the Environmental Protection Agency and/or required matching funds to increase funding capacity. Moody's Rating Agency (or Moody's) rates 55 state revolving funds in 28 states – a majority of these bonds are rated Aaa.[31]

As noted earlier, some states have incorporated their Clean Water State Revolving Fund and Drinking Water State Revolving Fund in their state bond bank operations, benefiting from additional credit enhancement given the state bond bank rating, while maintaining separate accounting and reporting requirements as the programs receive federal funds.[32]

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[29] See Kidwell, David S., and Robert J. Rogowski. "Bond banks: A state assistance program that helps reduce new issue borrowing costs." *Public Administration Review* (1983): 108-113.
[30] Requirements would be comparable to those required by the Treasurer's LOCAL Program.
[31] Also see Fitch (2018) "Majority of U.S. State Revolving Fund and Municipal Pool Programs Rated 'AAA'"
[32] See Maine Municipal Bond Bank

State Infrastructure Banks

State Infrastructure Banks are state-run revolving loan funds that offer financial assistance for transportation related projects mainly through low interest loans. The origin of state infrastructure banks can be traced to the initiation of environmental state revolving funds. A state infrastructure bank pilot program was authorized by the National Highway System Designation Act of 1995. Ten states (Arizona, Florida, Ohio, Oklahoma, Oregon, South Carolina, Texas, and Virginia) participated in the initial phase with California and Missouri subsequently being selected to establish state infrastructure banks.

There are currently three types of state infrastructure banks based on different sources of capitalization: federally capitalized, state-only capitalized, and hybrid programs**.** To date there are 33 federally capitalized banks that use a blend of federal and state matching funds to finance federally authorized projects. Kansas and Georgia created state-only capitalized state infrastructure banks exclusively with state funds. Hybrid infrastructure banks operate with separate federally with state matching funds and state-only capitalized accounts (e.g., Ohio, Florida, Pennsylvania, and Virginia). Washington's state infrastructure bank falls in the first category – federal with state matching funds.[33]

Like state revolving funds, state infrastructure banks use federal and state-matching funds to offer low-interest loans. Repayments from the first cycle are used to provide loans for a new set of projects. More than 1,100 projects nationwide have been supported by state and federally capitalized state infrastructure banks. They have a combined value of $7.3 billion. While this represents a fraction of state spending on transportation, states like South Carolina, Florida, Arizona, Texas, and California have established robust SIBs that account for more than three-quarters of state infrastructure bank activity to date.[34]

Two recent studies have found that for every $1.00 in federal capitalized state infrastructure bank seed funds, state and local government highway spending has increased by at least $2.50 and up to $3.00, three years after the state infrastructure bank investment was made.[35] A third study found state infrastructure banks lower the overall cost of capital for transportation projects and thus reduce the overall cost of the project. This can be done by either (a) providing low interest or interest free loans, which could be used to partially or fully replace taxable or tax-exempt debt, (b) offer credit enhancement that allow transportation projects to attain higher ratings for their municipal bonds, or (c) assist smaller jurisdictions and infrequent borrowers to obtain debt financing by pooling bond issues, thus spreading the risk and reducing the overall cost of capital.[36] It's important to note that these low interest rate loans do come at a cost as interest rates and loan terms

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[33] Chen, Can. "Banking on Infrastructure: Exploring the Fiscal Impacts of State Infrastructure Bank (SIB) Loans on Leveraging State and Local Transportation Investment." *Public Budgeting & Finance* 36.3 (2016): 94-113.

[34] Note, the data are from 1996-2010. See Puentes, Robert, and Jennifer Thompson. "Banking on Infrastructure: Enhancing State Revolving Funds For Transportation." (2012).

[35] See Chen, Can. "Banking on Infrastructure: Exploring the Fiscal Impacts of State Infrastructure Bank (SIB) Loans on Leveraging State and Local Transportation Investment." *Public Budgeting & Finance* 36.3 (2016): 94-113 and Ryu, Jay Eungha. "Federal Highway Assistance Funds in The State Infrastructure Bank Programs: Mechanisms, Merits, And Modifications." *Public Budgeting & Finance* 27.4 (2007): 43-65.

[36] See Yusuf, Juita-Elena, and Gao Liu. "State Infrastructure Banks and Intergovernmental Subsidies for Local Transportation Investment." *Public Budgeting & Finance* 28.4 (2008): 71-89.

are the two significant determinants of maintaining the corpus or principal value of any revolving fund. Mangers therefore need to balance the need to protect the financial viability of state infrastructure banks and the demands of low-cost loans.[37]

State Guarantee Programs

Six states (Utah, Idaho, Washington, Oregon, Michigan, and New Jersey) have established programs that guarantee the debt service of eligible local governments.[38] States that have established state guarantee programs have largely limited it to school districts.

With the guarantee, the state commits to draw on its general funds, reserve funds, or issue general obligation bonds, if necessary, to cure a debt service shortfall of a participating school district.

Since the state is the guarantor of the bonds, the state's general obligation rating is assigned to all bonds in the program. The guarantee program may be assigned a rating one or two notches above the state's rating based on the state's commitment and mandate to act and the degree of institutionalized state oversight. In Washington, school districts participating in the program are assigned a rating equal to the state's general obligation rating (AA+/Aa1). The Legislature modified the Idaho School Bond Guaranty program to allow two tiers of enhancement (by the state or by the state and the Endowment Fund Investment Board). Enhancement by the state enables school districts to receive a rating equal to the state's general obligation rating (currently Aa1/AA+) while the secondary enhancement with the Endowment Fund enables school districts to receive a rating one notch above the state's general obligation rating (or AAA/Aaa). If on the other hand the state guarantee is based on a moral obligation pledge, the state's moral obligation rating and not its general obligation rating would be assigned to the program (at least one notch below its general obligation rating).

State Intercept Programs

Intercept programs, which are in place in more than 20 states are based on a state's pledge to intervene in the event of a bond default by intercepting, or withholding, state aid payments due to the issuer and forwarding them onto bondholders.[39]

Ratings for intercept programs are based on the nature of the withholding mechanism and timeliness of payments to bondholders. Programs that are rated on par with appropriation debt (or one notch below general obligation ratings) if they provide for full and timely payment of debt service to the designated paying agent, regardless of the amount of undisbursed state aid due to the entity at the time of the intercept (i.e., a pre-default mechanism). Other programs are rated below the state's appropriation debt (two notches below general obligation ratings) as they only provide for payment

[37] See Chen (2016).
[38] Note, in four states, the state's general obligation rating is either AAA/Aaa or one notch below (at AA+/Aa1) except in the case of Michigan and New Jersey.
[39] Ely, Todd L. "Indirect Aid for Uncertain Times: The Use of State Credit Enhancement Programs." *Municipal Finance Journal* 33.2 (2012).

of debt service to the extent undisbursed state aid is available. Intercept programs that do not guarantee timely payment of principal and interest (i.e., post-default mechanism) are also rated two notches below the state general obligation rating.[40]

Note, state intercept programs are a form of credit enhancement that would directly benefit eligible local governments and public agencies. The program does not create an obligation for the state but rather extends a payment guarantee, on behalf of a local government, to the extent that state aid funds are available.

[40] S&P (2008) "State Credit Enhancement Programs"

Demand for Financial Services in Washington

To assess public agencies' satisfaction with current programs and services we administered a "User Needs Survey" to all cities, counties, public utility districts, and water/sewer districts in Washington State. The objective for this survey was simple: To identify unmet financial services needs that a public cooperative bank could meet uniquely, or meet more effectively than existing programs. We also gathered qualitative data on user needs from commercial banks, community banks, and credit unions.

Methodology

The survey was organized into three sections: 1) infrastructure financing; 2) capital markets advisory services; and, 3) investment options. Most of the questions asked the respondent to identify their satisfaction with an existing Washington State program, or their interest in a potential program. Questions regarding interest in participating in potential programs offered by a public cooperative state bank were framed as either yes/no/unsure or using the Likert Scale (1: Unlikely; 2: Somewhat Unlikely; 3: Neutral; 4: Somewhat Likely; 5: Likely). Some questions had follow-up components, while other questions had an optional open response component after Likert Scale questions. In the findings summarized below, key themes from these qualitative questions are summarized. A full description of the survey methodology and detailed findings can be found in Appendix B.

In all, 103 surveys were completed representing 100 different agencies and jurisdictions across Washington State. Participating agencies/jurisdictions included: cities, towns, counties, public utility districts, and water/sewer districts. Surveys were consistently completed by high-level individuals, in particular the mayor or city manager for cities, county treasurer for counties, and chief administrative officer or chief finance officer for utility and water/sewer districts. Figure 5 shows the geographic distribution of the city and county respondents, and Figure 6 shows the geographic distribution of the utility district respondents.

Figure 7 shows the average likelihood that a jurisdiction might use different products and services offered by a public cooperative bank, summarized by the type of product or service. It shows those likelihoods range from 2.94 out of 5, or just short of "neutral," for bond pooling, to 2.02 for cash management assistance programs.

Figure 5: Geographic Distribution of Survey Responses – Cities and Counties

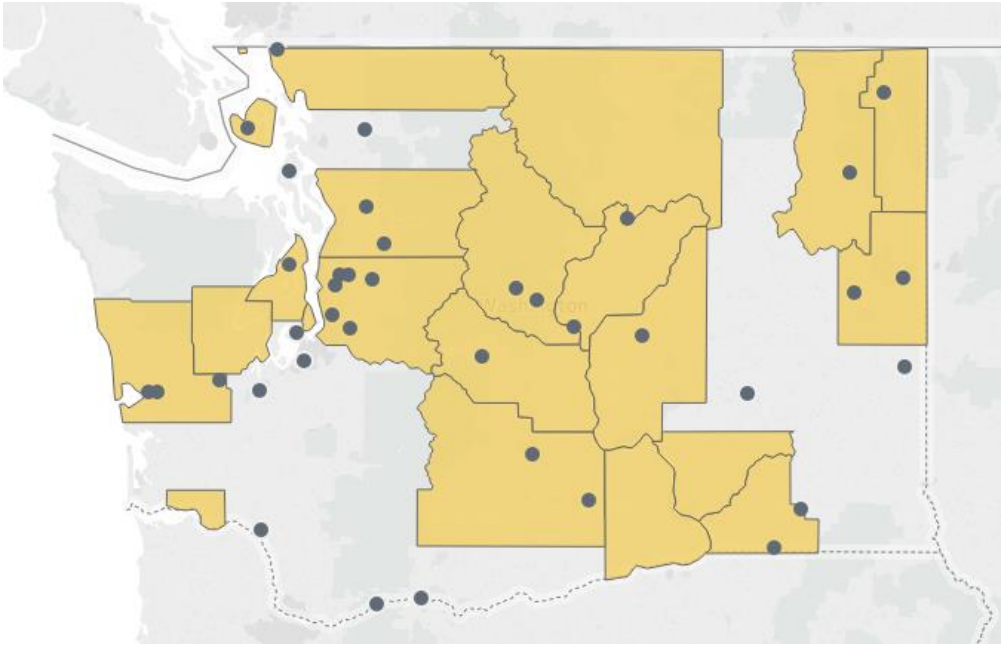


Figure 6: Geographic Distribution of Survey Responses – Utility Districts

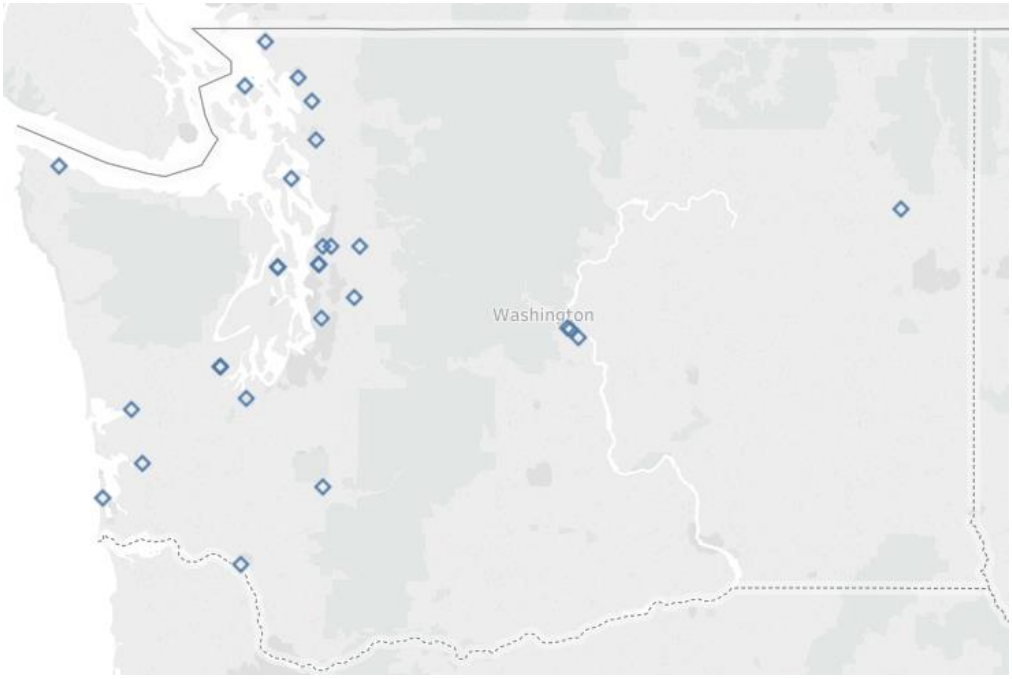


Figure 7: Average Likert Scale Scores - All Agencies and Jurisdictions



Gantt Percent and average of Score for each Question broken down by Category. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The data is filtered on Type of Agency/Jurisdiction, which keeps City / Town, County, PUD and WSD. The view is filtered on Answer and Category. The Answer filter excludes Null. The Category filter keeps Access to capital and Capital markets advisory services.

We complemented the User Needs Survey with perspectives from banks and credit unions. To gather those perspectives, we convened two focus groups. The first was organized by staff from the Washington Bankers Association and Community Bankers of Washington. It was held in Seattle on October 29, 2018 and included representatives from a total of seven commercial banks and community banks around the state, and staff from Washington Bankers Association and Community Bankers of Washington. The second was organized by the Northwest Credit Union Association and was held in SeaTac on November 6, 2018. It included representatives from six credit unions around the state, and staff from the association. Both sessions were scheduled for two hours and were facilitated by Mike Bailey, Finance Consultant with the Municipal Research and Services Commission. The sessions were not recorded but several study group members took detailed notes.

Both focus groups followed a semi-structured format organized around a series of questions designed to gather information about participants' perceptions about public agencies' need for financial services and their ability to provide them. Those questions – listed in Appendix C – cover

the same general topics as the User Needs Assessment survey. We shared those questions with the participants approximately two weeks before each session.

Infrastructure Financing

Survey participants were asked four questions regarding the likelihood that they would participate in state bank programming involving access to capital. The four access to capital programs were: bond pooling (explained as an expanded LOCAL program), an interim loan program, a lease-purchase financing program, and a pre-development loan program. Overall, survey participants' responses suggest that there is not a significant unmet need for capital for infrastructure financing: the average Likert scale score across all four sections was 2.45.

- LOCAL Program participation: It is interesting to note that only 18 percent of respondents' agency/jurisdiction had participated in the LOCAL program over the past 5 years, and that 7 percent of respondents were unaware that the LOCAL program existed, or were not sure as to whether their agency/jurisdiction was eligible to participate in LOCAL. Of the respondents that had not participated but were aware of LOCAL, the most common reason for agencies/jurisdictions not using the program was that they were able to borrow more cost effectively on their own. In the open response section, multiple respondents praised the LOCAL program – even if their agency/jurisdiction did not participate.

- Bond pooling program: Among infrastructure financing services programs, there was the most interest in a bond pooling program. While cities/towns were neutral regarding their participation (average Likert scale score = 3.0), and counties were not interested (average Likert scale score = 2.43), both public utility districts and water and sewer districts expressed interest in participation (average Likert scale score = 3.33 and 3.38). Among agencies/jurisdictions that were not interested in participating in bond pooling, the two most frequently given explanations were: no incentive to participate because agency has a high enough credit rating and thus would not benefit from a bond bank; and, agency does not issue bonds.

- Interim loan program: Among infrastructure financing services programs, there was the least interest in an interim loan program. Agencies/jurisdictions currently fund interim project costs through inter-fund loans, borrowing from financial institutions, and issuing bond anticipation notes. While in the open response section there were a few comments made that indicated smaller municipalities and municipalities in crisis might benefit from an interim loan program, overall, there was minimal interest expressed as evidenced by the average Likert scale score: cities/towns (2.38), counties (2.00), public utility district (1.63), and water/sewer district (2.73).

- Lease purchase financing program: There was low interest expressed in participating in a lease-purchase financing program. Only 5.4 percent of agencies/jurisdictions had participated in Washington's Certificates of Participation program over the past five years. Nearly one-third of agencies/jurisdictions reported that they prefer to avoid lease purchase financing: of the agencies/jurisdictions that do use lease purchase financing, most have adequate in-house expertise and would not benefit from outsourcing the process. The average Likert scale score

reflected this low interest: cities/towns (2.61), counties (1.90), public utility districts (2.44), and water/sewer districts (2.07).

- Pre-development loan program: With the exception of water/sewer districts, there was low interest in pre-development loan programs. 96 percent of agencies/jurisdictions currently fund pre-development internally through budget appropriations or other means, while a smaller number borrow from financial institutions and/or issue bond anticipation notes. However, agencies/jurisdictions did share in the comments section that while they do not currently have a need for such a program, they might have a need when large projects come up, and/or should their financial outlook change. This sentiment was reflected in the average Likert scale score =: cities/towns (2.25), counties (2.19), public utility districts (2), and water/sewer districts (3.15).

Focus group participants pointed out that many commercial banks, community banks, and credit unions offer infrastructure investment opportunities through a variety of products including small loans, leasing programs, and lines of credit. They did note that in some rural communities, capital markets access is thinner and more constrained than in other regions. However, no participant in either of the focus groups was aware of a capital project that did not happen because of a lack of private sector or state government-supported financing options.

Capital and Financial Markets Services

Survey participants were asked a variety of questions regarding the likelihood that they would participate in a public cooperative bank's programs involving various types of financial and capital markets services. Participants were asked whether they would engage a state public cooperative bank in financial advisory services and/or technical assistance. Additionally, participants were asked the likelihood of their participation/engagement of a state public cooperative bank in cash flow management assistance services.

Overall, survey participants responses suggest that there is not a significant unmet need for capital markets advisory services: 28 percent of all agencies/jurisdictions said they would engage technical assistance if provided by a public cooperative bank; 28 percent of all agencies/jurisdictions said they would engage financial advisory services if provided by a public cooperative bank; and, the average Likert scale score for cash flow management was 2.02.

Agencies and jurisdictions expressed that they would only be interested in using a public cooperative state bank for capital and financial markets services if, and only if, the state bank would provide cash flow management assistance at a lower cost than their current providers. Among agencies and jurisdictions not interested in using a public cooperative bank's services, even if they were available, the most common reason provided was that agencies/jurisdictions have very positive relationships with their local bank.

- Technical assistance: It is important to note that 46 percent of respondents were unsure as to whether or not they would engage technical assistance if offered by the public cooperative bank. The majority of agencies/jurisdictions that answered "no" to seeking technical assistance if offered reported having adequate in-house expertise on staff. Among agencies/jurisdictions that

answered "yes" to seeking technical assistance if offered by the public cooperative bank, the most common services wanted were: investment and cash flow management, reviewing financial management policies, and assistance streamlining transactions and internal processes.

- Financial advisory services: Similar to technical assistance, 46 percent of respondents were unsure as to whether or not they would engage financial advisory services if offered by the public cooperative bank, while 26 percent said they would engage financial advisory services and 28 percent said they would not engage. Most agencies/jurisdictions (80 percent) have used a financial advisor at some point. The most frequently used advisors include: Piper Jaffray, Northwest Municipal Advisors, PFM, and DA Davidson. In the comments section, agencies and jurisdictions expressed satisfaction with their current financial advisors.

- Cash flow management services: Consistently, the majority of agencies and jurisdictions shared that their current use of inter-fund loans provides them with adequate cash flow management assistance. To a lesser extent, agencies and jurisdictions also borrow from financial institutions, issue short-term warrants, and issue tax, revenue, or grant anticipation notes.

Focus group participants almost unanimously agreed that most public-sector agencies could benefit from better access to quality technical assistance and financial advisory services. In fact, several noted that banks and credit unions are often reluctant to take on new government clients because elected officials and appointed staff often lack a basic understanding of the mechanics and dynamics of the capital markets. In other words, governments are high transaction cost clients. They agreed that better access to training and professional development opportunities, as well as independent advice on strategies and tactics for navigating the capital markets, would add value at many levels.

Credit union focus group participants also repeatedly highlighted that they only recently received statutory authority to accept deposits from local governments.

Depository Services

Survey participants were also asked whether they would use depository services, if a public cooperative bank provided them. While there was some interest, most they would be unlikely or very unlikely to avail themselves of such services. The average Likert scale score for depository services was 2.48.

Agencies and jurisdictions expressed that they would only be interested in using a public cooperative state bank for depository services if, and only if, the public cooperative bank would provide these services at a lower cost than their current providers. Among agencies and jurisdictions not interested in using a public cooperative bank's services, even if they were available, the most common reason provided was that agencies/jurisdictions have very positive relationships with their local bank.

Across the board, agencies and jurisdictions shared that if they were to receive depository services from a public cooperative bank, they would need to have the following services: check clearing, automatic clearing house (process payroll, accounts payable, and move money electronically), and remittance processing.

Several credit union focus group participants described their nascent lines of business like check clearing and remittance processing for local governments. All credit union participants agreed that a public cooperative bank offering depository services, as well as other kinds of capital and financial markets services, would "pull the rug out" from an emerging line of business that's consistent with credit unions' core competencies and mandate to engage in broader community building.

Investment Services

Overwhelmingly, agencies/jurisdictions across the state rely on the Washington State Local Government Investment Pool for investment management. To a lesser extent, agencies/jurisdictions use both Local Government Investment Pool and either a bank or their County Treasurer, and a much smaller minority rely exclusively on either a bank or their County Treasurer. When considering where to place short-term investments, safety and environmental/social governance were far and above the most important factors, although agencies and jurisdictions also consider liquidity, supporting the local/regional economy, and maximizing high returns with low fees.

When asked "Would your agency/jurisdiction be interested in participating in any of the following investment opportunities through a state public cooperative bank" the responses indicated that there is a demand for additional investment opportunities, as evidenced by:

- 25.5 percent interested in Pooled Investments, Money Market Funds
- 22.6 percent interested in Pooled Investments, Intermediate Funds
- 19.7 percent interested in Pooled Investments, Bond Fund
- 23.6 percent interested in Pooled High Interest Savings Fund
- 8.6 percent interested in Other permissible investment opportunities

Agencies/jurisdictions reported they are currently receiving between 0.55 percent and 3.3 percent on their short-term investments. Further investigation into what rates agencies/jurisdictions would require to move their investments to a public cooperative bank will be needed to truly assess the demand for additional investment options that might be provided by the public cooperative bank.

Overall Attitudes Toward Public Banking

Survey responses indicated that a plurality of state and local public agencies and jurisdictions is uncertain whether they would benefit from public cooperative banking. On the question "Considering the services that a public cooperative bank might offer, do you think your jurisdiction/agency might have an interest in membership?" 32 percent said yes, 22 percent said no, and 46 percent said "unsure." However, many of those who said "unsure" expressed that they were satisfied with the services currently available through the state government, banks, and credit unions. and/or would require additional information about how the public cooperative bank would function to provide a decisive "yes" or "no" answer regarding their agency's interest in membership.

Focus group participants were unanimously skeptical about whether a public cooperative bank could add value in Washington State. They raised several specific concerns about the governance and operations of such a bank, including:

- Political Risk. How can the entity's governance structure prevent financially risky, but politically popular projects from securing investment funds from the public cooperative bank?
- Contagion. How would a default or other failure by one jurisdiction affect the other members? Could a public cooperative bank inadvertently concentrate financial risk in certain regions or certain types of jurisdictions?
- Local Investment. Participants agreed that a public cooperative bank could add value through the multiplier effect of localizing investments. But they also pointed out that "local" is relative. For instance, if a small city in Eastern Washington participated in a public cooperative bank, it's likely that some or all of their investment would ultimately mean more investment in Seattle or Bellevue. It's difficult to localize benefits in a large, diffuse state like ours.
- Capitalization. Participants also agreed that capitalizing a public cooperative bank through a state appropriation or other outlay of state resources is not an appropriate use of public resources.
- Staffing. Could a public cooperative bank compete with the private sector for qualified staff? Can it offer salaries, training, and advancement opportunities necessary to attract and keep the requisite talent? If not, how and where will it find appropriate staffing?
- Competitive Environment. Several participants pointed out that public banking has succeeded in regions – like North Dakota and American Samoa – that do not have a strong correspondent private sector banking system. However, this is not an issue in Washington State.

Structural Analysis of Potential Cooperative Banking Models

With this review of the scope of services and potential demand for those services, we now turn to the variety of models available to organize and govern a public cooperative bank to deliver those services.

Funding Generally

The public cooperative bank would have three principal functions of a traditional bank – accepting deposits from members, managing investments for members, and providing loans to members.

It is likely that the amount of deposits would be insufficient to satisfy member credit demand. The public cooperative bank could amplify its ability to lend to members by borrowing funds from the public. This is how the Federal Home Loan Banks are structured. Federal Home Loan Banks accept deposits from members, but the quantity of deposits is small relative to member loan demand. The Federal Home Loan Banks meet member credit needs by issuing bonds to the public. They then lend these funds to members at a small markup to cover operating costs. By borrowing large sums and through thorough collateralization of member loans (no Federal Home Loan Bank has ever defaulted on a public bond issue), the banks are able to obtain a high credit rating which enables them to borrow at only a few basis points above rates on equivalent maturity bonds issued by the U.S. government.

As a supplement or, possibly, an alternative to direct lending to members, the public cooperative bank could facilitate direct issuance of bonds by individual members to the public through a bond pool. The bond pool would enable members to spread issuance costs over a much larger amount of funds. This would be particularly beneficial to members that need to finance small infrastructure projects.

Membership

As prescribed in the budget proviso, membership in the public cooperative bank would be restricted to "…state and/or political subdivisions…."

Issue: Should membership be mandatory or voluntary?

Assuming that members are a source for providing contributions to capitalize a public cooperative bank, as discussed in the Legal Analysis of Potential Cooperative Banking Models ("Legal Analysis") section of this report, mandatory membership would result in attainment of critical mass to assure viability of a public cooperative bank. It would also avoid the possibility of adverse selection that might result from voluntary membership, if most larger state and political subdivisions opt out of membership. In addition, mandatory membership would spread risk broadly, which could avoid potential negative consequences for the state's bond rating and would benefit the public cooperative bank's external credit rating, should it issue bonds or borrow funds.

The principal objection to mandatory membership would be that it is coercive and would compel some state and political subdivisions to be members even if they believe the public cooperative bank would provide no substantive benefits to them.

Issue: If membership is voluntary, should non-members have access to the services of the public cooperative bank?

An option would be to structure the Public cooperative bank so that it could offer services to non-members (restricted to state and political subdivisions) at a fee without requiring capital contributions. Such an option could be appealing to those jurisdictions who believe their needs for the financial services provided by the public cooperative bank are limited but would like to retain the ability to access those services should the need arise. The problem with this option is the same as it is for voluntary membership in general. It would reduce the breadth of the membership base which contributes to the public cooperative bank's capitalization and in so doing could increase risks to a narrower membership base. Co-operatives exist for many purposes and almost without exception an entity must be a member of a cooperative to have access to the services it provides. For example, this is true for cooperatives such as the Federal Home Loan Banks, Farm Credit Banks, and credit unions.

Capitalization

Funds to capitalize the public cooperative bank have two purposes. The first should be primarily short-term, while the second will be on-going.

First, any new entity will require "initial funding" to hire staff, acquire furniture and equipment, lease or purchase operating systems, and otherwise invest in whatever is necessary to become a going concern which provides financial services to its members. Assuming that the public cooperative bank, once up and running, will be profitable, this need will diminish or even cease to exist. However, just as is the case for any business enterprise, future expansion, new services, or new operating systems may require funds that exceed profits generated and retained by the public cooperative bank.

Second, assuming that the public cooperative bank, as part of the financial services it provides to its members, extends credit, it will need funds to "absorb potential losses" should members default on borrowings.

Initial Funding

There are at least three options for providing initial funding:

1. Funds appropriated from the state budget in the form of a loan which would be repayable from the future earnings of the public cooperative bank or through member contributions to capital. Such a "loan" would have to be structured to be responsive to issues discussed in the "Legal Analysis."

2. Member contributions to capitalize the public cooperative bank. Such contributions would be characterized as "ownership interests." If ownership interests can be contributed in advance of incurring any start-up expenses, a "loan" from the state would not be needed. However, it is possible that a "loan" from the state could "kick start" establishment of a public cooperative bank.

3. Funds raised through issuance of bonds to the public. While feasible, this source of funding raises issues which are discussed in the "Legal Analysis," In addition, with respect to initial funding, it might be difficult to obtain a reasonable credit rating, given that the public cooperative bank would have no performance record. Generally, having an acceptable credit rating will depend not only on an entity's operating performance and financial strength, it will also depend upon the ability of the entity to absorb losses and avoid defaulting on the debt service requirements of bonds issued to the public.

Loss Absorbing Funding

There are two sources of loss absorbing funding:

1. Contributions from members. Pursuant to the discussion in the "Legal Analysis," member contributions would be treated as "ownership interests" and would capitalize a loss reserve. Each member's liability for losses would be limited to the amount it contributed to the loss reserve.

2. Subordinated debt issued to the public. Such debt would be subordinated to the loss reserve. If losses are incurred by the public cooperative bank which exceed the loss reserve, subordinated debt holders would absorb any additional losses. Obviously, this is not an alternative to member contributions, but rather a way of supplementing the loss absorbing capital of the public cooperative bank and thus strengthening its credit rating.

Structure of Member Ownership Interests

Because the public cooperative bank has two needs for capital – (1) initial funding to cover start-up costs and subsequent operating requirements and (2) loss absorbing funding – ownership interests will need to be divided into two classes. The initial funding class can be variable while the loss absorbing class will need to be permanent subject to credit risk exposure.

Issue: How should the aggregate amount of the initial funding class of ownership interests be determined?
With respect to initial funding, the amount needed can be estimated from the initial business plan to establish the public cooperative bank. Then each member's share can be determined by a methodology based upon a measure of the size of the jurisdiction. For example, one possible measure would be annual total revenues received by the jurisdiction. Each member's contribution would be pro rata to the size of its revenues relative to the aggregate revenues of all members. Obviously, voluntary membership as opposed to mandatory membership would add complexity to determining the amount of each member's share of initial funding.

A variation would be to divide this class of ownership interests into two subclasses – one based on membership and one based upon the member's use of financial services other than credit (see discussion below on structuring ownership interests for credit use). The membership subclass could be structured as described above and would remain fixed for as long as a jurisdiction is a member. The usage of services subclass would be tied to the amount of services utilized and would vary over time as the member's usage of services varies.

Issue: How should the aggregate amount of the loss absorbing funding class of ownership interests be determined?

It is reasonable to assume that over time the public cooperative bank's credit portfolio will grow in size and as that occurs, it will be essential to expand the size of the loss reserve.

One means of determining the amount of a member's contribution would be a percentage of the credit extended to the member. This percentage could be discounted depending upon the quantity and dependability of intercepts. The member's loss reserve contribution could be returned only when the credit extended to it by the public cooperative bank has been extinguished in full.

However, to obtain a preferred credit rating, the public cooperative bank would need a permanent loss reserve that is not solely dependent upon members' use of credit. This could be accomplished by dividing loss absorbing ownership interests into two subclasses – a permanent contribution based upon membership in the public cooperative bank, determined in a similar way to the initial funding ownership interest, and a variable contribution based upon a member's use of credit. For example, the Federal Home Loan Banks have both membership and activity-based member capitalization requirements.

Issue: If the public cooperative bank experiences a loss on a credit extended to a member, the loss reduces the loss reserve. How is this reduction in the loss reserve allocated to members?

First, some recovery of the loss may be possible through intercepts specific to the member's credit obligation. This is analogous to collateral backing bank loans. Second, to the extent that some loss remains, all members would share pro rata according to the proportion of their contributions of ownership interests to the loss reserve.

Issue: Is there a way to simplify determination of the amount of each member's ownership interests?

An alternative to a complex formula to calculate usage (activity-based) ownership interest requirements would be to permit the public cooperative bank to charge directly for the usage of certain types of services, such as financial advisory services, technical advice, and depository services. Ownership interest requirements for usage of financial services could be limited to management of cash and investments and use of credit.

Issue: How would ownership interests be structured?

While there could be different classes of ownership interests, as discussed above, the simplest way to treat ownership interests is to have a fixed par value for each unit of ownership interests. In the event that the loss reserve is reduced by a credit loss, the number of units of ownership interests would be reduced.

Note that a fixed par value would require the public cooperative bank to manage the monetary value of ownership interests to closely approximate par value at all times.

Issue: How would a member be compensated for its ownership interests?

Assuming the public cooperative bank is profitable, profits could be returned to members in proportion to the amount of their individual ownership interests relative to the aggregate amount of ownership interests of all members. This would be akin to declaring a dividend of a specific amount on each unit of ownership interests.

However, it is possible that the public cooperative bank might lose money on operations from time to time. To provide for such a contingency, some earnings could be retained in reserve. Such a retained profits reserve in the public cooperative bank would be similar to retained earnings in a private corporate entity.

There is another reason that retention of some portion of earnings might be prudent. That reason would be to cover the possibility that the value of each unit of ownership interests falls below its par value for reasons other operating losses.

Note that credit losses should not affect the decision to pay dividends or retain some portion of profits because credit losses would be allocated directly to the loss reserve.

Governance

In establishing a public cooperative bank there are three sets of governance considerations – composition and size of the board of directors, oversight of operations, and role of the state legislature.

In determining the composition of the board of directors, there are several objectives to keep in mind:

- Expertise – financial management, credit management, infrastructure finance, information technology, operations management would be among the more important areas of board member expertise
- Member representation
- Statewide elected officials
- Representatives of the public

In addition to composition considerations, the size of the board matters. It should be large enough to assure broad diversity, but not so large that it becomes unwieldy. Management literature and experience suggest a board size ranging from at least 9 members to no more than 15. Median board membership size is approximately 11.

There are many possible models. Some examples include:

- Federal Home Loan Banks. Members elect member directors and public interest directors. The number of votes each member has is determined by its stock holding in the bank; however, there is a cap on the maximum number of shares that a member can vote to limit the possibility of a very large member controlling the election of directors. In addition, each Federal Home Loan Bank has an affordable housing advisory board whose members are appointed by the board of directors.
- Washington State Investment Board. There are ten voting members and five non-voting members. The ten voting members include the Treasurer, a member of the House of Representatives, a member of the Senate, the Director of the Department of Retirement Systems, the Director of the Department of Labor and Industries, a representative of retirees and four members from beneficiaries, such as teachers, firefighters, etc. These ten directors then elect five non-voting members who have financial and investment expertise. The five non-voting members are not advisory but have full fiduciary responsibility.
- Federal Reserve Banks. Each bank has a board of nine – six are elected by members of the regional Federal Reserve Bank and three are appointed by the Board of Governors of the Federal Reserve System.

Issue: What might be the composition of the public cooperative bank board?
In the case of the public cooperative bank, the Washington State Investment Board offers a germane example of drawing directors from different groups of stakeholders (beneficiaries). Member directors of the public cooperative bank could include individuals from cities, counties, state agencies, ports, public utility districts, and possibly elected officials. In addition, directors with expertise in infrastructure finance, cash and investment management, credit oversight, financial markets, among other skills would be important to include.

Regulatory Oversight

State agencies typically are required to have independent auditors audit their financial statements. The State Auditor oversees operational audits of state agencies, but in some cases, such as the Washington State Investment Board, agencies have their own internal audit capability. Like most financial institutions, the public cooperative bank should have a robust internal audit capability.

In addition, state agencies customarily submit reports of activities to the state legislature and are subject to legislative oversight hearings.

Issue: Would independent financial statement audits and oversight by the State Auditor provide sufficient oversight?
If there is concern, a possible additional regulatory oversight agency would be the Department of Financial Institutions which has expertise in financial services and credit extension.

Another possibility is the Public Deposit Protection Commission whose members include the Governor, Lieutenant Governor, and Treasurer.

A hybrid oversight structure would have the Department of Financial Institutions have direct examination authority but the Public Deposit Protection Commission or a similarly structured body could serve as an oversight board. An example of such a structure at the federal level is the PCAOB which is a nonprofit corporation established by the U.S. Congress to oversee audits of public companies. Board members of the PCAOB are selected by the Securities and Exchange Commission, which has responsibility for examining the financial statements of public companies. Another example at the federal level was the Resolution Trust Corporation whose responsibility was to resolve failed savings and loans associations in the 1990s. It had a board of directors, but Congress also provided for an oversight board, which included the Secretary of the Treasury, the Chairman of the Federal Reserve System and the Director of the General Accountability Office.

A dual structure could provide at one level detailed oversight of the public cooperative bank's operations and at the oversight level review of policies and program initiatives.

Role of the State Legislature

As is discussed in the "Legal Analysis" below, the public cooperative bank would be chartered as a state agency by the Legislature. The statute would describe its purpose, its powers, its governance structure among other things. The legislature will always have the power to amend the statute which governs the activities of the public cooperative bank.

As is the case with government agencies generally which provide services, particularly financial services, there will be concern about the independence of the public cooperative bank. This concern flows directly from the recent diversion of funding from the Public Works Trust Fund to finance other legislative initiatives. This should be less of a concern if the public cooperative bank obtains its funding directly from its members and from the bond market and not from the state budget. Nevertheless, there could be concern about the Legislature at some future date diverting revenues from the public cooperative bank to other purposes. While the state government, as the chartering body creating the public cooperative bank will always retain the authority to change the terms of the charter, public cooperative bank members and financial markets will want governance to be structured so that this possibility is minimized.

Legal Analysis of Potential Cooperative Banking Models

The "base case" involves the state's formation of an instrumentality that would accept deposits and other investment funds from Washington governments and then lend that money to the governments themselves — potentially including loans both to governments that are and are not member-owners of the public cooperative bank. The entity would be capitalized by contributions from the member-owners. That capital could also be supplemented by government deposits and by the proceeds of bonds issued by the public cooperative bank to the public.

In an alternative approach — a "bond bank" concept — the public cooperative bank would periodically form pools of local government borrowers that desire to raise money collectively for specific projects. The public cooperative bank would then issue bonds and lend the proceeds to members of the particular pool. Loan repayments would provide for repayment of the underlying bonds.

Regardless of which lending approach the public cooperative bank used, the entity also might provide financial advisory services to Washington local governments.

The legal analysis presented here concludes that an intergovernmental public cooperative bank can be created in Washington state, but would require enacting a substantial authorizing statute and amending various existing statutes. A range of options are lawfully available for capitalizing a public cooperative bank and structuring its services. Some possible credit-support tools to backstop a public cooperative bank's obligations would likely require a constitutional amendment to avoid making state or local guarantees count against the state's or local governments' debt limits. As discussed below, some of these constitutional provisions are the same ones that make it very challenging to consider establishing a "North Dakota" style government bank that takes deposits from private persons, guarantees those deposits, and makes loans to the private sector.

This section of the report first provides a decision agenda. Next, it focuses on legal parameters. Finally, it analyzes each concept choice in light of the major legal issues.

Key Policy Choices

A public cooperative bank presents a variety of legal questions that are relevant to policymakers. One way of organizing those questions is: (1) What programs would the public cooperative bank engage in — loans to governments? Financial advisory services? Other? (2) How would a public cooperative bank be capitalized, and what would be the source of funds for loans — member investments? Other investments? State appropriations? Deposits? Borrowings? (3) What security would be provided for repaying funders?

It might be useful to think in terms of concrete program models:

Option 1 – Pure Credit Union Model: Members lending entirely (or primarily) to each other

***Funding Sources*:** Member capital investments, deposits, earnings

***Possible Security*:** Intercepts of borrower revenues, pledged taxes, pledged revenue streams, pledged assets, member capital investments

Option 2 – Credit Union Model plus Borrowed and Other Funds

***Funding Sources*:** Member capital investments, state appropriations, outside capital investments, deposits, earnings, borrowings

***Possible Security*:** Intercepts of borrower revenues, pledged taxes, pledged revenue streams, pledged assets, member and other capital investments, member cross-collateralization, state liquidity support, state guarantees

Option 3 – Pure Bond Bank Model

***Funding Sources*:** Initial member capital investments, borrowings

***Possible Security*:** Intercepts of borrower revenues, pledged taxes, pledged revenue streams, pledged assets, member capital investments (loan-loss reserve), member cross-collateralization, state liquidity support, state guarantees

Add-on Option

Financial advisory services

Relevant Constitutional Provisions and Statutes

The following section outlines significant legal parameters affecting some or all the possible options. It first identifies key constitutional provisions and statutes to consider in structuring a public cooperative bank and in drafting its statute. It reviews federal and state regulatory matters that should be taken into account. The memo then returns to the potential options listed above, and analyzes them in light of the various legal parameters. Appendix D identifies likely components of an authorizing statute and describes some ancillary policy choices.

Relatively few state constitutional provisions are relevant to the formation and operation of an intergovernmental public cooperative bank. None of them would prevent the Legislature from

authorizing such an entity. Below are constitutional parameters to take into account, along with a short discussion of each provision's relevance.

Article VII, Section 6 and Article VIII, Section 4

Art. VII, Sec. 6 and Art. VIII, Sec. 4 control the deposit and expenditure of tax money. Art. VII, Sec. 6 requires that all money the state receives from taxes levied and collected for state purposes must be paid into the state Treasury. Art. VIII, Sec. 4 requires a legislative appropriation for all amounts held in the Treasury, and case law has made it clear that the Legislature cannot bind itself (or a succeeding Legislature) by making appropriations that last more than a biennium.[41] Some non-tax revenues (*e.g.*, tolls, fees, insurance premiums and federal grant funds) may be deposited in nonappropriate accounts "in the custody of" the Treasurer, and a statute may permit those amounts to be spent without additional legislative appropriation. But tax money is always deposited in the Treasury, and leaves the Treasury solely when a proper appropriation is made. The significance of these two sections for a State Co-op Bank is that if the Treasurer were authorized to deposit Treasury money into the Bank, those funds would be like any other Treasury investments, *i.e.*, amounts still in the Treasury until they are appropriated for a specific purpose, with the Treasurer retaining the ability to withdraw the deposits in accordance with the terms of deposit agreements. If, on the other hand, the state were to become a member of the Bank and make capital contributions to it, each such expenditure of state money, and subsequent Bank-related expenditures, would require express appropriation.

Article VIII, Section 1 and Article VIII, Section 6

Art. VIII, Sec. 1 and Art. VIII, Sec. 6 delineate maximum state and local government debt capacity, respectively. In Washington, government "debt" (borrowings subject to debt limits) is defined as borrowed money payable from taxes, and excludes revenue obligations.[42] The relevance here is that care must be taken to avoid the inadvertent creation of either state or municipal debt. Obviously, when and if local governments borrow from the public cooperative bank and pledge taxes to repay the loans, those obligations will be charged against the borrowing governments' general obligation debt capacities. But credit support provided by member-owners of the Bank could also count against debt limits, and there likely would be interest in avoiding that. For example, the state Treasurer's LOCAL program was carefully structured under RCW 39.94.030(4)(a) to avoid the creation of state "debt" when the Treasurer causes the issuance of certificates of participation in a pool of financing contracts for the acquisition of local government equipment and infrastructure.[43] The state provides liquidity and temporary credit support, but the structure and statutory language counters the formation of state debt. A Washington State Supreme Court decision was necessary to

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[41] Kristen L. Fraser, *Method, Procedure, Means, and Manner: Washington's Law of Law-Making*, 39. Gonz. L. Rev. 447, 476-79 (2003-2004).

[42] *State ex rel. Wittler v. Yelle*, 65 Wn.2d 660 (1965); *Winston v. Spokane*, 12 Wash. 524 (1895)(the first reported case in the country treating non-tax revenue bonds as outside constitutional debt limits).

[43] RCW 39.94.030(4)(a) states, in part: "Financing contracts and contracts for credit enhancement entered into under the limitations set forth in this chapter do not constitute a debt or the contracting of indebtedness under any law limiting debt of the state. It is the intent of the legislature that such contracts also do not constitute a debt or the contracting of indebtedness under Article VIII, section 1 of the state Constitution. Certificates of participation in payments to be made under financing contracts also do not constitute a debt or the contracting of an indebtedness under any law limiting debt of the state if payment is conditioned upon payment by the state under the financing contract with respect to which the same relates. It is the intent of the legislature that such certificates also do not constitute a debt or the contracting of indebtedness under Article VIII, section 1 of the state Constitution if payment of the certificates is conditioned upon payment by the state under the financing contract with respect to which those certificates relate."

confirm that the language of that statutory provision was effective in preventing the creation of state debt."[44] It may be that as a policy matter, the intergovernmental public cooperative bank would function on a stand-alone basis without state credit support, and that would avoid the potential for causing a charge against the state's debt capacity. However, if public cooperative bank members, or state and local borrowers from public cooperative bank, were asked to guarantee or cross-collateralize loans made by the Bank, or if capital calls are required such that those calls are in fact loan guarantees, then those guarantees might be treated as debts of the guarantors. This is suggested by a 2012 decision involving a city's guarantee of bonds issued by a separate municipal corporation.[45] At the same time, the multiple and somewhat confusing opinions provided by the state Supreme Court in that case have left Washington governments unclear as to how much debt capacity might be consumed by a such guarantees.[46] The inadvertent creation of state or local government debt can be avoided by capitalizing a loan-loss reserve and clearly excluding public cooperative bank members or borrowers from liability in excess of their investment, or individual loans, respectively.

Article VIII, Sections 5 and 7 and Article XI, Section 9

Art. VIII, Secs. 5 and 7 of the Washington Constitution, together with Art. XI, Sec. 9, prohibit the state and local governments from giving away public funds to private persons, companies or associations without corresponding consideration, or from providing credit support or loans to private sector entities. There is an exception when the gift, loan or credit support is for "the necessary support of the poor and infirm." However, because the public cooperative bank would be a public body making loans to other public bodies, those constitutional prohibitions would not apply. Art. VIII, Sec. 7 and Art. XII, Sec. 9 also prohibit local governments and the state, respectively, from owning stocks and bonds of any private association, company or corporation. Although it would be lawful for state and local governments to own equity interests in a purely government public cooperative bank, the standard, prudent practice is to avoid using the terms "stock" and "shares." In analogous arrangements such as joint operating authorities under Chap. 43.52 RCW (*e.g.*, Energy Northwest) there are "member" governments, and for joint power development arrangements under Chap. 54.44 RCW, there are simply ownership "interests."

These constitutional provisions originated from the constitutional drafters' aversion to interlocking relationships between the public and private sectors. Consequently, the involvement of private investments in a public cooperative bank would have to be structured carefully to avoid any public credit guarantees or support to private parties. For example, Chap. 54.44 RCW allows for public-private joint development of power facilities, but it limits public entity risk at the amount invested and prohibits public entity credit support for the private entities involved in the joint venture. If a public cooperative bank statute allowed that entity to raise capital from the private sector, the

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[44] *Department of Ecology v. State Finance Committee*, 116 Wn.2d 246 (1991).

[45] *In re Bond Issuance of Great Wenatchee Regional Events Center Public Facilities District* 175 Wash.2d 788 (2012). The lead opinion's analysis in that case would have similar debt capacity implications for a public bank, akin to the North Dakota model, that takes private sector deposits and guarantees their repayment.

[46] If a decision is made to structure public cooperative bank loans so that members guarantee, or borrowers cross-collateralize, those loans, or so that capital calls can be made to backstop unpaid loans, care must be taken to expressly authorize those actions in the new statute. The most important holding in Washington Public Power Supply System fiasco was that absent express authorization, Washington local governments lacked the authority to sign "step-up" contracts cross-collateralizing the obligations of their fellow governments to WPPSS. *Chemical Bank v. Washington Public Power Supply System*, 99 Wash.2d 772 (1983).

legislation would need to similarly limit public risk of loss to public investments, with no public backstops for private institutions involved in the joint venture.

It should be noted that prior to establishing its different model of a public bank that makes loans to the private sector, North Dakota had to first obtain from its voters an amendment changing its Washington-like constitutional language to a more flexible version.[47]

One of the core principles of the Washington Constitution's handling of fictitious legal persons (*e.g.*, corporations) is that every such entity must be created pursuant to a general law rather than being individually chartered by the Legislature. The Constitution's 1889 populist drafters wanted to prevent the influence-peddling and bribery associated with the grants of charters both to private and municipal entities in the 19th century.[48] The only exception is the formation of *State* agencies and instrumentalities. The Washington State Bar Association, for example, was declared by the Legislature to be "an agency of the state" when it was statutorily created[49] in 1933 and membership was mandated for all Washington lawyers. The implication of these constitutional provisions is that an intergovernmental public cooperative bank either (1) should be directly created by a statute that forms the public cooperative bank within a state agency or that declares the entity to be an "agency" or an "instrumentality" of the state (or both)[50] or (2) should be formed by a charter under a statute permitting the state to charter more than one such entities as state instrumentalities. "State instrumentality" status is helpful in avoiding municipal advisor registration requirements under the Securities Exchange Act, and having a state-issued "charter" might be a prerequisite to enabling a public cooperative bank to gain access to payment systems and account services potentially available through the Federal Reserve Bank of San Francisco.

Basic Statutory Authority

No Washington statute currently authorizes the type of public cooperative bank contemplated here, or authorizes State and local governments to contribute capital to or invest in such an entity. Arguably, first-class charter cities, charter counties and optional municipal code cities have authority to form and capitalize a public cooperative bank, but that power is not clear and in any event it does not include the authority to make deposits or investments in a public cooperative bank. A single statute could perform multiple functions: form the entity; prescribe its governance structure; determine membership eligibility, outline its specific powers (*i.e.*, corporate powers, depository functions, authority to make loans, advisory powers); and authorize state and local agencies to capitalize and make deposits and investments in the public cooperative bank.

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[47] Section 185 of North Dakota's original Constitution, drafted in the same year as Washington's, stated: "Neither the state nor any county, city, township, town, school district or any other political subdivision shall loan or give its credit or make donations to or in aid of any individual, association or corporation, except for necessary support of the poor, or subscribe to or become the owner of the capital stock of any association or corporation…."

[48] *See*, James Leonard Fitts, *The Washington Constitutional Convention of 1889* 549 (unpublished master's thesis, Univ. of Washington, 1951); Robert F. Utter & Hugh D. Spitzer, *The Washington State Constitution* 191 (2013).

[49] RCW 2.48.010.

[50] *See, e.g.*, RCW 43.180.040(1), which creates the Washington State Housing Finance Commission as "an instrumentality of the state exercising essential government functions."

There are numerous statutes that would also need to be amended, and the Office of Code Reviser could help identify all of them. This would be a significant process, and requires careful attention to detail. Existing laws requiring amendment include, among others:

- *Chap. 39.59 RCW*, which provides an array of investment options for local governments. Contributions to the capital of a public cooperative bank could be added to RCW 39.59.040 as an authorized investment.
- *Chap. 43.84.080*, which details authorized investments of amounts in the State Treasury. It could be amended to include contributions to a public cooperative bank's capital as an authorized investment.
- *Chap. 39.58*, which establishes the Public Deposit Protection Commission and governs authorized depositories and collateralization requirements for public funds. A decision would need to be made as to whether the intergovernmental public cooperative bank itself would be required to collateralize government deposits in the Bank, or whether the mandatory collateralization provided by private sector depositaries with whom the public cooperative bank places its funds will suffice. Attention should also be given to the broader question of the fiduciary obligations of state and local treasurers with respect to the prudence of their investments.
- *Chap. 39.94 RCW*, which authorizes state agency borrowings through financing contracts and also authorizes the LOCAL program. The potential amendment here would be with respect to state agencies if they were authorized to borrow from the public cooperative bank. Chap. 39.94 provides for Office of the State Treasurer and State Finance Committee oversight of certain types of borrowings, and decisions would be needed regarding how that statute should mesh with the one providing for the public cooperative bank.
- *Chap. 43.320 RCW*, which creates the Department of Financial Institutions (DFI), together with a constellation of other statutes granting oversight and regulatory powers to DFI. These include, for example, the Washington State Credit Union Act (Chap. 31.12 RCW); the Washington Commercial Bank Act (Title 30A RCW); the Washington Savings Bank Act (Title 32 RCW); the Washington Savings Association Act (Title 33 RCW); and the Securities Act of Washington (Chap. 21.20 RCW). These and other financial regulation statutes might need adjustments if and to the extent it is desired to exclude the public cooperative bank from DFI regulation.
- *Chap. 43.33A RCW*, governing the State Investment Board (SIB). Under RCW 43.44A.030, the SIB has a "trusteeship" over public pension funds it manages, and RCW 43.33A.035 states that voting members of the SIB are "fiduciaries." RCW 43.33A.140 requires the SIB to use a "prudent person" standard in making investment decisions, with the board members exercising "reasonable care, skill, prudence, and diligence" in developing and carrying out investment policies. Consideration would need to be given to whether SIB deposits or investments in a public cooperative bank would be compatible with those statutory standards.[51]

[51] Express legislative authorization for one type of State Investment Board investment is provided in RCW 43.33A.080, which allows the State Investment Board to invest in certain farm ownership and soil and water conservation loans fully guaranteed by the U.S. government.

- *Chap. 39.64 RCW*, prescribing eligibility for Washington local governments to file for "Chapter 9" municipal bankruptcy under federal law. 11 U.S.C. § 109(c) allows state agencies and instrumentalities to be defined as "municipalities" for purposes of the bankruptcy code. Alternatively, the statute could prescribe a receivership or similar process for handling a public cooperative bank's inability to honor its financial obligations, if that were to occur.

Express language in the public cooperative bank authorizing statute could affirmatively state that a capital investment in the Bank is an authorized investment for the State Treasurer, for state and local agencies, and for government pension funds (if applicable). It could also grant those government entities express authority to deposit their funds in the Bank.

Safe drafting practice, as well as a state constitutional ban on amending statutes indirectly,[52] suggests that the public cooperative bank should be referenced in many statutes besides the one authorizing its formation. These and other potential statutory adjustments are listed in Appendix D.

State and Federal Regulatory Oversight and Services

Potential oversight would arise from state entities described in the section immediately above, *e.g.*, the Public Deposit Protection Commission, the State Finance Committee and the Department of Financial Institutions. The public cooperative bank statute, together with amendments to existing statutes, can specify the extent to which any of the agencies would (or would not) have regulatory authority over the Bank.

Drafters of public cooperative bank legislation should also consider the role of the State Treasurer and the State Auditor with respect to the entity. Would the State (presumably through the Office of the State Treasurer) be a member? Whether or not the state is a member, would the Treasurer have a special oversight role? Would the State Treasurer serve as treasurer of the public cooperative bank? Could the board appoint its own treasurer? Could the board appoint an independent auditor, such as the one permitted for Energy Northwest under RCW 43.52.375? Would that separate auditor additionally be subject to audit by the State Auditor? Further, would the Legislature play any formal role in overseeing the Bank and its operations?

If the intergovernmental public cooperative bank were created as a state agency or instrumentality, and if the members and borrowers are all state agencies or political subdivisions, the public cooperative bank likely will be exempt from regulation by the Federal Reserve Bank, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Commission or the National Credit Union Administration. Participation in Federal Reserve Bank payments systems and account services might cause the entity to be subject to certain Federal Reserve regulations.

The Federal Reserve Banks payments systems and account services enable participants to wire funds directly and to undertake certain other transactions without going through (and paying fees to) a financial institution that participates in that system. In order to participate, an entity either must be

[52] Article II, Section 37 states: "No act shall ever be revised or amended by mere reference to its title, but the act revised or the section amended shall be set forth at full length."

eligible for FDIC insurance (whether or not it uses FDIC insurance), or the entity must become a member of a Federal Reserve Bank by purchasing stock in that bank in a minimum amount equaling 6 percent of the member's paid-up capital and surplus. Because of the restrictions of Article XII, Section 9, a public cooperative bank (or any type of state bank), as a Washington governmental body, probably could not purchase stock in the Federal Reserve Bank of San Francisco because of the latter's private characteristics. A public cooperative bank might be structured so that it would be eligible for FDIC insurance, and qualify that way. However, the Federal Reserve Banks do not hold government accounts (other than the Federal Reserve Bank of New York, which holds U.S. Treasury funds). The bottom line is that there is a trade-off between structuring a public cooperative bank as a state agency (thus avoiding securities and most federal financial regulations) or creating it as a chartered private entity (enabling it to participate in Federal Reserve Bank systems but subjecting it to a substantial number of regulations).[53] It would be relatively easy for a public cooperative bank to handle its payment services, processing, wires and certain other operations though a "banker's bank" that provides services to banks only.

If the public cooperative bank is authorized to provide certain financial advisory functions, it appears that the Bank and its employees will be exempt from the municipal financial advisor requirements of the Securities Exchange Act and related rules promulgated by the Securities Exchange Commission and the Municipal Securities Rulemaking Board. SEC Rule § 240.15Ba1-1 defines a "municipal advisor" as "a person (who is not a municipal entity or an employee of a municipal entity) that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities…." A "municipal entity" is in turn defined to include "any State, political subdivision of a State, or municipal corporate instrumentality of a State or of a political subdivision of a State, including: (1) Any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (2) Any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (3) Any other issuer of municipal securities. The intergovernmental public cooperative bank would be both an instrumentality of the State and a "plan, program, or pool of assets sponsored by the State."

If the public cooperative bank were authorized to borrow money in order to capitalize itself or to provide "bond bank" functions, and if that borrowing involved the issuance of bonds to the public, then the Bank and its bond offerings would have to comply with certain federal securities laws and regulations. If the borrowings were on a tax-exempt basis, the Bank and its bonds would have to comply with applicable federal tax laws and Internal Revenue Service rules.

In addition, a public cooperative bank would likely obtain its own Employee Identification Number from the IRS, as do other semi-independent instrumentalities of the state such as the Washington State Housing Finance Commission.

[53] Membership of the public cooperative bank in the Federal Home Loan Bank system (through the Federal Home Loan Bank of Des Moines) was considered. However, membership in a Federal Home Loan Bank is restricted to certain institutions, particularly those engaged in mortgage lending. As a cooperative bank for Washington governmental entities, the state public cooperative bank studied here is not conceived to be a lender to homebuyers.

Considering Each Option in Light of Legal Parameters

This section analyzes each concept choice in light of the major legal considerations relevant to that option. The memorandum then reviews policy questions presented by all the options.

Option 1 - Pure Credit Union Model: Members lending entirely (or primarily) to each other

- *Funding Sources*: Member capital investments, Deposits, Earnings
- *Possible Security*: Intercepts of borrower revenues, Pledged taxes, Pledged revenue streams, Pledged assets, Member capital investments

Considerations for this option include:

- Relative simplicity of concept and operation.
- Capitalized by members.
- Members' risks limited to respective capital contributions.
- Would deposits be accepted from some, or all, local governments and state agencies?
- Security for loans is straightforward, external credit support is unnecessary.
- Amounts available for lending (*i.e.*, loss absorbing funding) are limited to capital contributions. and deposits. Borrowing demands could easily outstrip supply.

Option 2 - Credit Union Model plus Borrowed and Other Funds

- *Funding Sources*: Member capital investments; Outside capital investments; Deposits; Earnings, Borrowings, State Appropriations
- *Possible Security*: Intercepts of borrower revenues, Pledged taxes, Pledged revenue streams, Pledged assets, Member and other capital investments, Member cross-collateralization, State liquidity support, State guarantees

Considerations for this option include:

- Increases amounts available for loans by adding borrowed funds to contributed capital and deposits.
- Direct State capitalization would require one or more appropriations and/or allocations of specified revenue sources.
- Requires provision of additional security for bond owners, such as an identified loan-loss reserve fund, cross-collateralization by members, State liquidity support or State guarantees. However, cross-collateralization or State guarantees raise constitutional debt limit questions and might be unavailable.
- Would deposits be accepted from some, or all, local governments and state agencies?
- Would deposits and/or investments be accepted from the State Investment Board and other public pension governing boards?

- While any private-sector investments must be structured on an arms-length, joint-venture basis rather than stock ownership, would those investments be structured to mimic the characteristics of common stock and preferred stock?
- Would private sector loans to a public cooperative bank be structured with varying pledge positions and characteristics that mimic senior and subordinated (loss-absorbing) debt?
- Borrowed money through bond issues are subject to federal securities regulations.
- Subordinated debt issued to the public would require heightened disclosure of risks to purchasers of that debt.
- Borrowed money through bond issues are subject to IRS regulations if interest on the bonds is excluded from gross income for federal income tax purposes.
- Blind pools, where bond proceeds would be loaned to yet-to-be-identified borrowers, would require taxable rather than tax-exempt bonds
- Other?

Option 3 — Pure Bond Bank Model

- *Funding Sources*: Initial member capital investments, Borrowings
- *Possible Security*: Intercepts of borrower revenues, Pledged taxes, pledged revenue streams, Pledged assets, Member capital investments (loan-loss reserve), Member cross-collateralization, State liquidity support, State guarantees

Considerations for this option include:

- Relative simplicity of concept and operation.
- Requires provision of additional security for bond owners, such as an identified loan-loss reserve fund, State liquidity support or State guarantees. However, State guarantees raise constitutional debt limit questions and might be unavailable.
- Bond bank approach is similar in many respects to existing State LOCAL program, suggesting that a bond bank might be unnecessary if the LOCAL program can be expanded in terms of types of loans (*i.e.*, broader than equipment and real estate) and expanded in terms of pledged security (*i.e.*, revenue pledges added to general obligation and asset pledges).
- Borrowed money through bond issues are subject to federal securities regulations.
- Borrowed money through bond issues are subject to IRS regulations if interest on the bonds is excluded from gross income for federal income tax purposes.
- Blind pools, where bond proceeds would be loaned to yet-to-be-identified borrowers, would require taxable rather than tax-exempt bonds.
- Other?

Add-on Option

- Financial Advisory Services

Considerations for this option include:

- Private sector services already available to most if not all localities.
- Care must be taken to with respect to federal securities regulations.

Policy Considerations Pertaining to All Options:

The details of all the main options present many policy choices, including those listed below. Additional questions are raised by what is included in the authorizing statute, as suggested in Appendix D.

- Should the entity be directly created by the Legislature as within an existing State agency, or as a free-standing agency/instrumentality of the State, or chartered pursuant to a general law?
- Who could join as members? All or just some local governments? The State Treasury? Other State agencies and instrumentalities?
- Should membership be mandatory for certain classes of local governments?
- Would loans be made to some, or all, local governments and state agencies?
- Would there be limitations on the purposes for which loans are made? Loan size?
- What would the members' capital investment level, and could there be a call for additional capital investments?
- Would members cross-collateralize each other's obligations (raises potential debt limit issues)
- How would excess revenues (*i.e.*, "profits") be determined and distributed?
- How would be governance be structured?
- What special role, if any, would be entrusted to the State Treasurer, the State Auditor, the Department of Financial Institutions and/or other State agencies?
- Would the Legislature have a role in overseeing operations and/or lending?
- Who would audit the public cooperative bank?
- How broad would be authorized investments of the entity? Should a constitutional amendment be proposed to permit investments in private sector equity/debt (similar to the authorization provided the Washington State Investment Board)?
- How would borrower intercepts be structured? What about local governments that receive very little in state shared revenues or sales tax distributions (*e.g.*, water-sewer districts, public utility districts)?
- What mechanism would be included if the entity encounters solvency problems?

Financial Risk Analysis of Potential Cooperative Banking Models

As this state-sponsored cooperative bank could provide services akin to those offered by current municipal pool or credit enhancement programs, we have evaluated the potential that these programs could affect the state's general obligation rating (currently AA+/AA+/Aa1 as assigned by S&P, Fitch and Moody's).

In brief, our analysis found that widespread use of municipal pool and credit enhancement programs has no discernible effect on sponsoring state government general obligation ratings. Our review determined that these programs are well-managed and the legal frameworks used to establish these programs mitigate potential losses. For example, in crafting the legislation to establish programs, states have been careful not to create any new long-term obligations for the state (e.g., the state is a sponsoring entity, not an obligor), created loss-recovery mechanisms to recover funds as a result of a default (e.g., municipal pool programs have state-aid intercept mechanisms embedded in their structure) and created extensive systems of credit monitoring and financial oversight. [54] If the state sponsored cooperative bank is established as an agency, independent of the operations of the state, any changes to the credit quality of the cooperative bank could have a limited to no effect on the state's credit rating.[55]

Below we provide a brief review of the rating criteria typically applied to credit enhancement programs.

Municipal Pool Programs

Unlike state intercept programs and guarantee programs, ratings assigned to municipal pool programs are independent of the state and reflect the credit profile of the underlying program obligors.

In assigning ratings to these programs, credit rating agencies review the following:

- Program loan portfolio including the type of obligation (general obligation versus revenue), type of obligor and repayment pledge (taxing versus nontaxing obligor), liens reported under each obligation, diversity of the pool of obligors as measured by percentage of principal outstanding, etc.
- Program cash flow model and debt service reserve fund. The cash flow model is used to stress-test the municipal pool program's ability to make timely payment on obligations assuming

[54] There is one exception: If the legal framework used to establish the cooperative bank is akin to a guarantee program (e.g., Washington School Bond Guarantee program), this would likely have a negative impact on the state's rating. That's because the guarantee program creates a contingent liability that would need to be reported in the state financial reports and continuing disclosures. Because the liabilities reported by the cooperative bank would likely be larger than the existing School Bond Guarantee program, those liabilities would have a direct and detrimental effect on the state's general obligation rating.

[55] Because the state sponsored cooperative bank does not create an obligation for the state, negative changes to the bank's rating would not have a significant impact on the state's general obligation rating. However, if the cooperative bank were to default or collapse, there is potential for contamination effects as the bank is an agency of the state.

nonpayment by a portion of obligors. These nonpayments would likely require the pool to draw funds from the debt service reserve fund. In most instances, the debt service reserve fund should be at least the lesser of (a) the maximum annual debt service, (b) 10 percent of bond proceeds or (c) 125 percent of average annual debt service.

- Late payment or default history and probability of recovery. That includes a review of the debt payment processes and any debt-recovery or nonrepayment frameworks. For example, a clear majority of pool programs have state-aid intercepts that allow them to recover funds from defaulting obligors.

Every municipal pool program has mechanisms in place for monitoring credit quality of borrowers to ensure full and timely payment of borrowed funds. They have also established application and review processes and minimum credit criteria for potential obligors, including confirming the legal authority of their pledge to incur debt (e.g., voter approval) and assessment of debt affordability.

A vast majority of state revolving fund debt is rated Aa1/AA+ and above, based on the following features: (i) the presence of a large and diverse portfolio of loans to investment grade municipalities, (ii) strong essentiality of projects financed by the loans to underlying borrowers, (iii) programs' ability to withstand loan repayment shortfalls through over-collateralization of loan to bonds, large reserves and other available fund balances, (iv) federal regulations and, in some cases, indenture provisions that limit the ability to remove excess funds from the program, and (v) a track record of strong program and portfolio management.[56]

Our review of rating reports found little or no reference to the ratings assigned to their respective state. Notwithstanding, credit rating agencies do review if the state has provided explicit support to the program as an instrument of last resort. These include the use of a moral obligation pledge and/or pledged revenues. In the case of Idaho's state bond bank, the state has pledged sales tax revenues to it. Vermont has pledged to fund the bond reserve fund with proceeds from state-issued moral obligation bond should the reserve fund ever fall below required levels. Where the state is using a moral obligation pledge in support of the debt service reserve fund, and if the state's rating on the moral obligation pledge is higher than the municipal pool, credit rating agencies will substitute the lower pool rating with the state higher moral obligation pledge rating.

State Intercept Programs

Washington does not have a formal intercept program that extends beyond the certificate of participation or the School Bond Guarantee programs. States that do have a formal intercept program have established mechanisms that allow the Treasurer to make payments on behalf of a local government if the local government expects it will default on its obligations.

The credit quality of an intercept program is a function of the mechanisms that exist to divert funds to the paying agent in the event a local government cannot make full and timely debt service payment. In general, intercept programs that have a pre-default mechanism have a higher rating (one

[56] See Moody's (2013) "Rating Methodology: U.S. State Revolving Fund Debt."

notch below the state's general obligation rating) relative to those with a post-default mechanism where diversion of state aid would be made after the local government defaults on its obligations (one notch below state moral obligation rating). Programs may be rated two notches below the state's general obligation rating if available state aid exceeds 2xMADS (or maximum annual debt service), thereby reducing the risk that available state aid would be insufficient to cover debt service.

State Guarantee Programs

Guarantee programs create a contingent obligation for the guarantor (the state government). In other words, if the locality were to default on its obligation, the state would make payments on behalf of the school district (i.e., obligor) through maturity until such time the school district is able to make payments on its own.

With the guarantee, the state commits to draw on its general funds or reserve funds, or issue general obligation bonds if necessary, to cure a debt service shortfall of a participating school district. Given the commitment the state has made, the state is required to report a contingent liability in its financial statements and bond disclosure documents. This would likely have a negative effect on the state's general obligation rating. However, most states, including Washington, maintain strong oversight over participating school districts and have in place intercept mechanisms (see below) that allow the state to recover funds. As such, the probability that a guarantee program would have a substantial negative effect on the state's general obligation rating is negligible.

Conclusion

This status report focused on the first half of the mandate stated in the Legislature's budget proviso: an evaluation of the benefits and risks of establishing a state-chartered, public cooperative bank.

Based upon an examination of previous studies and an assessment of what other states and cities are doing, it is clear that financial services used by state agencies and political subdivisions can be enhanced in ways that improve access and lower costs and which do not adversely impact the state's credit rating.

Improvements can be achieved by creating a state-chartered public cooperative bank. Legal analysis indicates that creation of such a bank is feasible under the state's constitution but would require an enabling statute and the amendment of many statutes.

Alternatively, enhancements could be made to the powers of many of the 80 separate programs administered by the State Treasurer and the departments of Commerce, Ecology and Health, among others. In concept, however, a public cooperative bank could offer some, many or all the products and services provided by these programs separately or in tandem in ways that improve access and execution and lower costs.

State political subdivisions responded to a financial services needs assessment survey (response rate = 19 percent). Responses indicated that a plurality, 46 percent, of state and local public agencies is uncertain whether they would benefit from public cooperative banking; 32 percent expressed interest and 22 percent indicated no interest. Many of those that were uncertain expressed that they were satisfied with the services currently available through the state government, banks and credit unions. However, survey responses indicated that local governments are interested, in varying degrees, in specific products and services that would satisfy unmet needs, which a public cooperative bank could provide. This is especially the case for smaller, rural jurisdictions.

The findings presented in this status report are intended to inform the creation of a business plan for a state-chartered, public cooperative bank, subject to any additional guidance from the Legislature.

Appendix A: Summary of Prior Studies of Public Banking

Summaries included for the following studies:

City of San Francisco, 2018
City of Seattle, 2018
City of Santa Fe, 2018
State of New Jersey, 2018
City of Los Angeles, 2018
State of Vermont, 2013
State of Hawaii, 2012
State of Massachusetts, 2011
State of Oregon, 2011
State of Maine, 2011
State of Washington, 2010

City of San Francisco, Ongoing 2018[57]

The City of San Francisco is currently investigating the feasibility of establishing a municipal bank through an ongoing nine-month (to-date) study done by the City and the County of San Francisco Municipal Bank Feasibility Task Force. The formation of the Task Force, which was created by Treasurer Jose Cisneros, was recommended by the Board of Supervisors in resolution 152-17. The Task Force's research goals were: to study the feasibility of a municipal bank, investigate the divestment of the City's pooled portfolio, and the feasibility of replacing commercial banks currently used for the City's banking needs with a public entity. The Task Force reviewed available literature; held seven public meetings; held monthly cross-municipality exchange forums; met with diverse groups of stakeholders including community banks, credit unions, Community Development Financial Institutions, and affordable housing advocates and developers; and, met with government officials from other jurisdictions, including both Washington State and Seattle.

With the goal of providing the Board of Supervisors and the Mayor with information to guide future policy decisions around public banking, the Task Force's report provides four potential models for a municipal bank: 1) a Wholesale Municipal Bank modeled after the Bank of North Dakota, would provide real estate, small business, and student loans; 2) a Wholesale Municipal Bank Plus Specialty Products, would be an expanded version of the Wholesale Municipal Bank and would also offer direct lending small business and small-dollar consumer loans; 3) Municipal Commercial Lending, which would offer the products of Model One (except for student lending) as a commercial lender; 4) a Hybrid Approach, which would entail starting the entity as a municipal commercial lending program that over time would transition into a municipal bank.

[57] See Public Banking in the United States - A Literature Review: Memorandum to the San Francisco Municipal Bank Feasibility Study Task Force (2018), but note that the summary above was informed by the full draft report, which has not yet been made public (was provided to the Evans School team by Scott Merriman, OFM)

City of Seattle, November 2018[58]

The City of Seattle issued a public RFP for a municipal bank feasibility study in February 2018, and hired H&A Advisors to complete the study. H&A Advisors completed the study with the City Council's two goals in mind: 1) the primary goal of discontinuing its use of Wells Fargo; and, 2) the secondary goal of providing banking services to the public.

The study concluded that the present legal and regulatory structures in place are not conducive to the creation of a public bank, and that consequently establishing a municipal bank in Seattle will at best a long-term process. However, the study concluded with optimism about the possibilities inherent in a public bank, specifically the notion of a public bank as a financial institution that is directly connected to the community's values. The study concludes with a set of steps the City should take if the Council wishes to move forward with establishing a municipal bank.

City of Santa Fe, April 2018[59]

The City of Santa Fe published a ten-month study done by the Santa Fe Public Bank Task Force, whose members were appointed by Mayor Javier Gonzales in April 2018. The formation of the Task Force was recommended by the City Council in resolution 2017-32. The Task Force's research goals were to advise the Mayor and City Council on the pros and cons of chartering a public bank. The Task Force held regular public meetings, interviewed stakeholders including the New Mexico Regulation and licensing department and the Santa Fe banking community, collaborated with local and regional political and business leaders, and undertook a review of Santa Fe's financial information in partnership with the City's Finance Department.

The Task Force came to four major conclusions: 1) the City Finance Department has made significant progress internally towards completing the recommendations given in the Public Bank Feasibility Study which was issued in January 2016; 2) there are considerable legal and regulatory hurdles that would need to be overcome through legislation in order for a Public Bank to be established; 3) if a Public Bank were restricted to managing only the City of Santa Fe's financial assets, such a bank would have minimal benefits at best and would be non-viable at worst; 4) the Task Force investigated the gaps a Public Bank could fill that the City's Finance Department cannot, and found that a Public Bank could help leverage investment towards the City's economic development and could support the City's community banks, credit unions, and CDFIs. Following these conclusions, the Task Force made three recommendations: 1) the City's Finance Department could use the findings of the report to develop and improve their offerings; 2) the Mayor and City Council could advocate at the state level for the passage of legislation that could lead to the creation of a statewide Public Bank in which Santa Fe could participate; and, 3) the Mayor and City Council could establish a standing committee responsible for better coordinating a financial network in the City to maximize public, private, and philanthropic investment in community economic development.

[58] See Public Bank Feasibility Study for the City of Seattle (2018)
[59] See Santa Fe Public Bank Task Force Final Report to the Santa Fe City Council (2018)

The Task Force's research goals were: to study the feasibility of a municipal bank, investigate the divestment of the City's pooled portfolio, and the feasibility of replacing commercial banks currently used for the City's banking needs with a public entity. The Task Force reviewed available literature; held seven public meetings; held monthly cross-municipality exchange forums; met with diverse groups of stakeholders including community banks, credit unions, Community Development Financial Institutions, and affordable housing advocates and developers; and, met with government officials from other jurisdictions, including both Washington State and Seattle.

State of New Jersey, April 2018[60]

A professor at Stockton University provided a series of policy briefs on issues impacting the citizens of the state: her fourth brief was "Exploring a Public Bank for New Jersey: Economic Impact and Implementation Issues." It is unclear who the report was funded by, but the report was inspired by the newly elected Governor's campaign calls for an independent state bank. The report was published while the New Jersey Legislature was considering the "State Bank of New Jersey Act" (Senate Bill No. 885). The report is focused on using multiplier analysis to estimate the economic impact of the creation of a state bank: the report concludes with a recommendation for the legislature to move forward with a public bank feasibility study.

City of Los Angeles, February 2018[61]

A ten-month study was done by City Council staff after the City Council introduced a motion initiating the study of the feasibility and barriers of the City creating a state-chartered public bank.

The report concludes that given the current legal and regulatory barriers, establishing a municipal bank would is not likely feasible. The report suggests that the City move forward by: 1) hiring a consultant to perform a cost-benefit analysis on creating a municipal bank; 2) reviewing and improving existing housing and economic development programs; and, 3) performing a policy brief on issues around cannabis banking.

State of Vermont, December 2013[62]

In 2013, a pro-public banking advocacy coalition, "Vermonters for a New Economy" commissioned a public bank feasibility report. The report was published with comments from municipal bank skeptics. The goal of coalition in investigating a public bank was to find whether a public bank could meet the state's unmet capital needs. While the report finds that there would be many advantages in job creation and dollars saved with a public bank, the report also acknowledges that there are a variety of risks associated with establishing a public bank, including the cost of capitalization, lost tax revenue, and the downgrading of the state's bond rating.

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[60] See Exploring a Public Bank for New Jersey: Economic Impact and Implementation Issues (2018)
[61] See Public Bank Framework and Existing Housing and Economic Development Programs (2018)
[62] See Exploring a Public Bank for Vermont: Economic Impacts, Capital Needs, and Implementation (2013)

The report concludes that given the high start-up costs associated with capitalizing a public bank, the coalition recommends that the already-existing Vermont Economic Development Authority operates a bank pilot program. Additionally, critics of the report believe that the bank has a significant flaw in that it assumes the bank could both lend a large percentage of its deposits while also meeting Vermont's sizeable liquidity needs.

State of Hawaii, January 2012[63]

The Commissioner of the Division of Financial Institutions reviewed the New England Public Policy Center of the Federal Reserve Bank of Boston's report "The Bank of North Dakota: A model for Massachusetts and other states?" with Hawaii's context in mind. The memo concludes that given the findings of the New England report that establishing a state bank would not be a sound policy decision for Hawaii. The memo highlights that Hawaii should focus on re-evaluating and revising existing state programs to address any perceived gaps in financial services in the state.

State of Massachusetts, August 2011[64]

The Massachusetts State Legislature passed Chapter 240 to create a commission to study the feasibility of establishing a public bank: the study was done by the Federal Reserve Bank of Boston. The Commission was tasked with investigating the feasibility of a public bank with the following legislative goals in mind: 1) stabilizing the state economy; 2) improving local business' access to credit; 3) augmenting the lending capacity of private banks; and, 4) contributing to the state government's revenue. The Commission found that while the Bank of North Dakota works well for the state, given Massachusetts context, a similar institution would not meet Massachusetts' goals. Thus, the Commission recommended that the Legislature not move forward with pursuing a public bank.

State of Maine, May 2011[65]

In 2011, the Center for State Innovation published a report for Maine (very similar to the reports the Center for State Innovation published for Oregon and Washington in 2010) investigating the effect a state bank might have in improving lending and employment during an economic downturn. Commissioned in the wake of the financial recession, the report was intended to serve as a conversation starter in exploring a public bank as a means to: 1) increase liquidity; 2) spur lending and development. It is important to note that it is unclear who funded the report. The report explores possible effects of a state bank on the state banking market, the impacts increased lending would have in jobs created and/or retained, returns on assets to the bank, and returns to the state.

[63] See Should Hawaii Establish a State Bank? (2012)
[64] See Report of the Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth (2011)
[65] See Maine State Bank Analysis -- Center for State Innovation (2011)

In the report's conclusion, the analysts acknowledge that the analysis serves as a starting point, and is an "admittedly simplified" estimation of the effect a Maine State Bank might have on the state's financial health, banking industry, and small businesses. The report ends with a strong suggestion that a state bank would positively impact Maine's revenue, and has the potential to both strengthen the existing banking industry and create jobs for Mainers.

State of Oregon, December 2010[66]

In 2010, the Center for State Innovation studied the effect a state bank might have in improving job creation/retention, lending, state revenue, and other positive economic impacts. Commissioned in the wake of the financial recession, the report was intended to serve as a conversation starter in exploring a public bank as a means to provide increased liquidity and stability to the Oregon economy. It is important to note that it is unclear who funded the report. The report explores possible effects of a state bank on the state banking market, the impacts increased lending would have in jobs created and/or retained, returns on assets to the bank, and returns to the state.

In the report's conclusion, the analysts acknowledge that the analysis serves as a starting point, and is an "admittedly simplified" estimation of the effect an Oregon State Bank might have on the state's financial health, banking industry, and small businesses. The report ends with the following questions for policymakers moving forward: the most politically feasible source for start-up capital; the origin and scope of the bank's deposits; the limitations and parameters of the bank's loans; and, finally, the question of a state dividend.

State of Washington, December 2010[67]

In 2010, the Center for State Innovation published a very similar version of the Oregon report for Washington, investigating the effect a state bank might have in improving lending and employment during an economic downturn. Commissioned in the wake of the financial recession, the report was intended to serve as a conversation starter in exploring a public bank as a means to: 1) improve lending in a poor economy; 2) improve unemployment through improved lending. It is important to note that it is unclear who funded the report. The report explores possible effects of a state bank on the state banking market, the impacts increased lending would have in jobs created and/or retained, returns on assets to the bank, and returns to the state.

In the report's conclusion, the analysts acknowledge that the analysis serves as a starting point, and is an "admittedly simplified" estimation of the effect a Washington State Bank might have on the state's financial health, banking industry, and small businesses. The report ends with the following questions for policymakers moving forward: the most politically feasible source for start-up capital; the origin and scope of the bank's deposits; the limitations and parameters of the bank's loans; and, finally, the question of a state dividend.

[66] See Oregon State Bank Analysis - Revised -- Center for State Innovation (2010)
[67] See Washington State Bank Analysis -- Center for State Innovation (2010)

Appendix B: User Needs Assessment Methods and Detailed Findings

Needs Assessment Design

The research team drafted a needs assessment survey in August 2018 and sought feedback from the Office of Financial Management, Washington State Treasurer's Office, Washington Ports Association, Association of Washington Cities, County Officials, Washington Public Utilities District Association, Washington Association of Sewer and Water Districts, Washington State Association of County Treasurers, Washington City/County Management Association (via the Municipal Research and Services Commission), and the Washington Finance Officers Association. The Washington Finance Officers Association chose to not participate.

Organizations were given two to three weeks to provide written or verbal feedback on the needs assessment survey. Feedback was sourced via email and over the phone, with the exception of the Office of Financial Management and the Washington State Treasurer's Office, from whom we received feedback in-person.

The most significant edits made after receiving feedback were to shorten the length of the needs assessment survey and condense open response questions. In early October, the research team shared edits and informed organizations as to how their input had been incorporated into the final needs assessment survey. Shortly thereafter, the research team requested that the partner organizations disseminate the needs assessment survey to their constituents.

Sampling Technique and Participants

The needs assessment survey was administered to membership lists identified by the following organizations: Association of Washington Cities, County Officials, Washington Public Utilities District Association, Washington Association of Sewer and Water Districts, Washington State Association of County Treasurers, and Washington City/County Management Association. The survey was distributed by partner organizations through an anonymous link to Qualtrics. All survey responses were collected online through the Qualtrics platform: the first survey was submitted October 19, 2018 and the last survey was submitted November 16, 2018. A copy of the survey instrument is available from the authors upon request.

In all, 103 surveys were completed representing 100 different agencies/jurisdictions across Washington State. The breakdown by type of agency/jurisdiction was as follows: 39 city/town; 29 county; 13 public utility district (public utility district); 18 water/sewer district (water/sewer district); and, 4 other. From each agency/jurisdiction type, the most frequent job title of the respondent is as follows: mayor or city administrator (city/town); county treasurer (county); finance manager (public utility district); and general manager (water/sewer district). This is a response rate of approximately 19 percent, an acceptable rate that suggests findings can be generalized. Upon the survey's close, data analysis was done with Qualtrics, Excel, and Tableau. The geographic distribution of the respondents is shown in the maps in the main report.

Findings

The findings are organized into three sections: (1) access to capital, (2) financial and capital markets services, including technical assistance, financial advisory services, cash management and depository services, and (3) investment advisory services. In-depth analysis was done through investigating survey responses by the type of agency/jurisdiction (city/town, county, public utility district, water/sewer district). When appropriate, qualitative responses from short answer sections of the survey are included to provide additional context and substance to the results. A summary of these findings appears in the main report.

Questions regarding interest in participating in potential programs offered by a public cooperative state bank were framed as either yes/no/unsure or using the Likert Scale (1: Unlikely; 2: Somewhat Unlikely; 3: Neutral; 4: Somewhat Likely; 5: Likely). Some questions had follow-up components, while other questions had an optional open response component after Likert Scale questions. In the findings section below, key trends and summaries from these qualitative questions are included.

Access to Capital

Survey participants were asked questions regarding the likelihood that they would participate in four state bank public cooperative bank programs involving access to capital: bond pooling (explained as an expanded LOCAL program), an interim loan program, a lease-purchase financing program, and a pre-development loan program.

Overall, survey participants responses suggest that there is not a significant unmet need: the average Likert scale score across all four questions was 2.45. A breakdown of the average score for each question is below, with further detail about how different types of agencies and jurisdictions responded to questions regarding programs for access to capital. Figure B1 shows the average score, across all types of jurisdictions, for each of the "access to capital" questions.

Only 18 percent of respondents' agency/jurisdiction had participated in the LOCAL program over the past 5 years, and 7 percent of respondents were unaware that the LOCAL program existed, or were not sure as to whether their agency/jurisdiction was eligible to participate in LOCAL. Of the respondents that had not participated but were aware of LOCAL, the most common reason for agencies/jurisdictions not using the program was that they were able to borrow more cost effectively on their own, and, to a lesser extent, because of timing-related issues. In the open response section, multiple respondents praised the LOCAL program as being well-established and useful – even if their agency/jurisdiction did not participate.

Figure B1: Access to Capital Likert Scale – All Agencies / Jurisdictions



The average Likert score for cities and towns was slightly higher than the average score at 2.56. Cities and towns were most interested in participating in a bond pooling program, but it is important to note that the overall interest was a score of 3, or neutral. When given an opportunity to explain why cities were not interested in participating in a bond pooling program, the two top reasons given were: 1) our agency does not issue bonds; and, 2) there is no incentive to participate because our agency/jurisdiction has a high enough credit rating. In line with average trends, cities and towns were the least interested in pre-development and interim loan programs. Figure B2 shows the average scores for each "access to capital" question for cities.

Figure B2: Access to Capital - Cities



The average Likert score for counties was 2.13, which was significantly lower than the overall average score. Figure B3 shows the average scores for each "access to capital" question for counties. Counties were most interested in participating in a bond pooling program, but it is important to note that the overall interest was a score of 2.43, which is less than neutral. When given an opportunity to explain why counties were not interested in participating in a bond pooling program, the two top reasons given were: 1) there is no incentive to participate because our agency/jurisdiction has a high enough credit rating; 2) our agency/jurisdiction has strong relationships with existing market institutions and would not benefit from a bond bank; and, 3) our agency/jurisdiction possesses adequate in-house expertise on the debt management process. Counties were the least interested in a lease purchase financing program.

Figure B3: Access to Capital – Counties



Gantt Percent and average of Score for each Question broken down by Category and Type of Agency/Jurisdiction. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The view is filtered on Answer, Type of Agency/Jurisdiction and Category. The Answer filter excludes Null. The Type of Agency/Jurisdiction filter keeps County. The Category filter keeps Access to capital.

The average Likert score for public utility districts was 2.35, which was slightly lower than the overall average score, but notably public utility districts were – on average – interested in participating in a bond pooling program (Likert score of 3.33). Figure B4 shows the average scores for each "access to capital" question for public utility districts. Two public utility agencies provided reasons for why they would not participate in a bond pooling program: the reasons given were; 1) our agency does not issue bonds; and, 2) our agency/jurisdiction has a high enough credit rating and would not benefit from a bond bank. Public utility districts were the least interested in an interim loan program.

Figure B4: Access to Capital – Public Utility Districts



Figure B5 shows the average scores for each "access to capital" question for water/sewer districts.. The average Likert score for water/sewer districts was 2.83, which was slightly higher than the overall average score. Notably, water/sewer districts were – on average – interested in participating in both a bond pooling program (Likert score of 3.38) and a pre-development loan program (3.15). Water/sewer districts that were not interested in participating in a bond pooling program provided two primary reasons: 1) our agency does not issue bonds; and 2) there is no incentive to participate because our agency/jurisdiction has a high enough credit rating and would not benefit from a bond bank. Water/sewer districts were the least interested in a lease purchase financing program.

Figure B5: Access to Capital Markets – Water/Sewer Districts



Gantt Percent and average of Score for each Question broken down by Category and Type of Agency/Jurisdiction. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The view is filtered on Answer, Type of Agency/Jurisdiction and Category. The Answer filter excludes Null. The Type of Agency/Jurisdiction filter keeps WSD. The Category filter keeps Access to capital.

Financial and Capital Markets Services and Depository Services

Survey participants were asked a variety of questions regarding the likelihood that they would participate in capital markets advisory services, including financial advisory services and technical assistance, provided by a public cooperative bank. Participants were also asked about the likelihood of their participation/engagement in cash flow management assistance services provided by the public cooperative bank. Survey participants were also asked whether they would utilize depository services if such services were provided by the public cooperative bank.

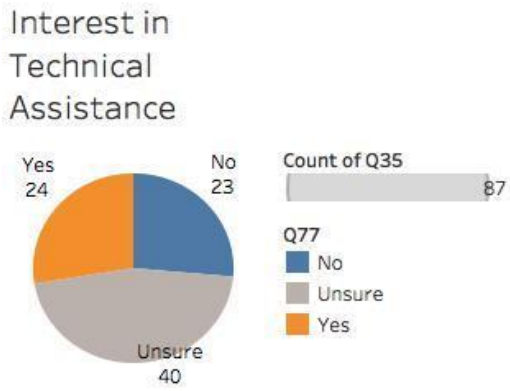
Overall, survey participants responses suggest that there is not a significant unmet need for financial and capital markets services: 28 percent of all agencies/jurisdictions said they would engage technical assistance if provided by a public cooperative bank; 28 percent of all agencies/jurisdictions said they would engage financial advisory services if provided by a public cooperative bank. The average Likert scale score for cash flow management services was 2.15, indicating a low level of interest. The average Likert scale score for depository services was 2.68, indicating some interest but a score below the neutral level of 3 means that a majority of respondents are not interested.

Consistently, the majority of agencies and jurisdictions shared that their current use of inter-fund loans provides them with adequate cash flow management assistance. To a lesser extent, agencies and jurisdictions also borrow from financial institutions, issue short-term warrants, and issue tax, revenue, or grant anticipation notes. Across the board, agencies and jurisdictions shared that if they were to receive depository services from a public cooperative bank, they would need to have the following services: check clearing, automatic clearing house (process payroll, accounts payable, and move money electronically), and remittance processing.

Agencies and jurisdictions expressed that they would only be interested in using a public cooperative state bank for cash flow management assistance and depository services if and only if the public cooperative bank provided such services at a lower cost than their current providers. Among agencies and jurisdictions not interested in using a state bank's services, even if they were available, the most common reason provided was that agencies/jurisdictions prefer to use their local bank.

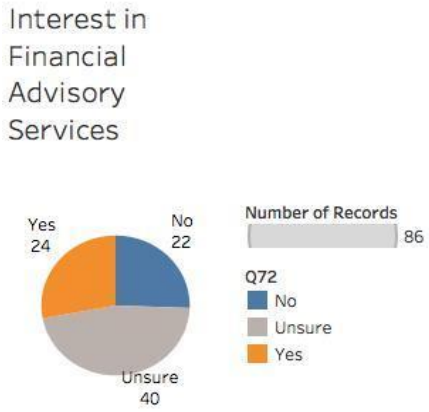
A breakdown of the average score across each question is below, along with further detail about how different types of agencies and jurisdictions responded to the questions. Figure B6 shows the interest in technical assistance across all jurisdiction. Figure B7 shows the interest in financial advisory services across all jurisdictions. Figure B9 shows the average scores across all jurisdictions for the two capital markets advisory services questions.

Figure B6: Interest in Receiving Technical Assistance - All Agencies/Jurisdictions



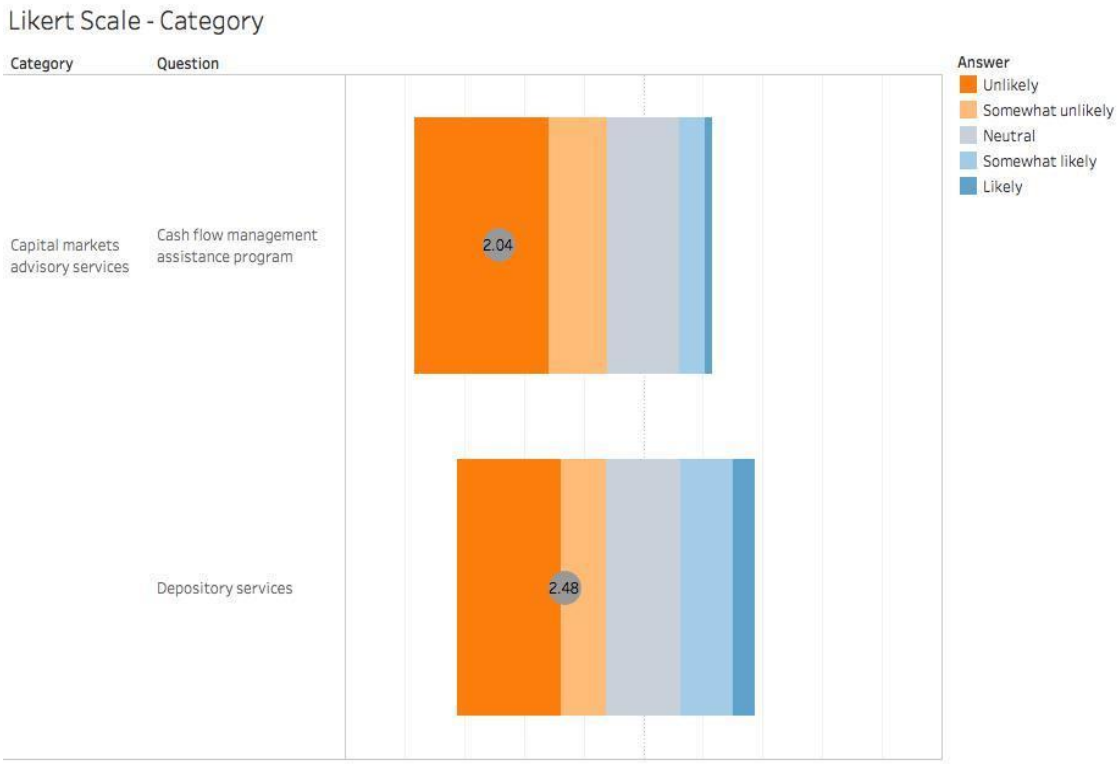
Q77 and sum of Number of Records. Color shows details about Q77. Size shows count of Q35. The marks are labeled by Q77 and sum of Number of Records. The data is filtered on Agency Type, which excludes Type of agency / jurisdiction. The view is filtered on Q77, which excludes Null.

Figure B7: Interest in Receiving Financial Advisory Services - All Agencies/Jurisdictions



Q72 and sum of Number of Records. Color shows details about Q72. Size shows sum of Number of Records. The marks are labeled by Q72 and sum of Number of Records. The data is filtered on Agency Type, which keeps City / Town, County, Other, PUD and W/SD. The view is filtered on Q72, which excludes Null.

Figure B8: Capital Markets Advisory Services – All Agencies/Jurisdictions



Gantt Percent and average of Score for each Question broken down by Category. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The view is filtered on Answer and Category. The Answer filter excludes Null. The Category filter keeps Capital markets advisory services.

Overall, cities and towns were more interested in financial and capital markets services than average: 39 percent of cities/towns said they would engage technical assistance if provided by a public cooperative bank; 36 percent of cities/towns said they would engage financial advisory services if provided by a public cooperative bank. The average Likert scale score for cash flow management services was 2.15 and the average Likert scale score for depository services was 2.68, which were both slightly higher than the overall averages of 2.04 and 2.48, respectively. Figure B9 shows the level of interest among cities in technical assistance. Figure B10 shows the level of interest among cities in financial advisory services. Figure B11 shows the level of interest among cities in capital markets advisory services.

Figure B9: Technical Assistance –Cities

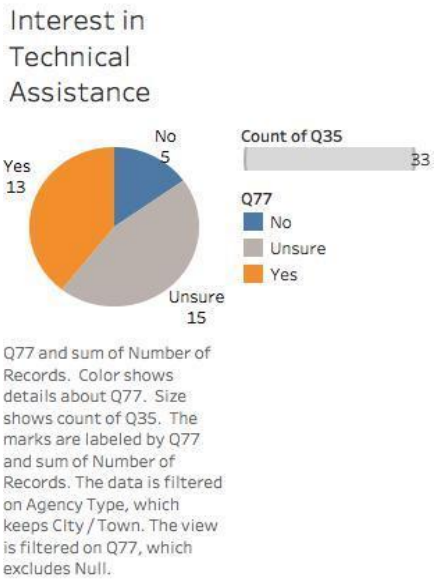


Figure B10: Financial Advisory Services – Cities

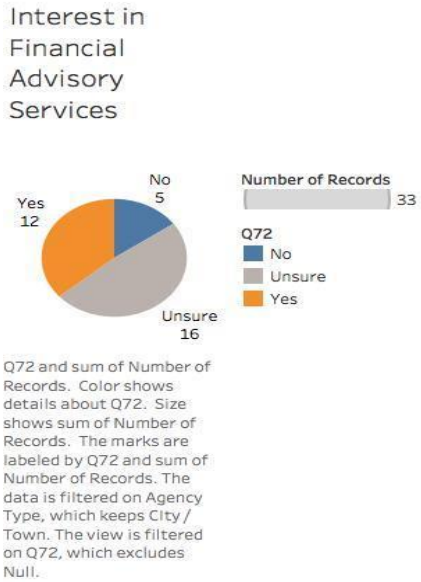


Figure B11: Capital Markets Advisory Services – Cities



Gantt Percent and average of Score for each Question broken down by Category and Type of Agency/Jurisdiction. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The view is filtered on Answer, Type of Agency/Jurisdiction and Category. The Answer filter excludes Null. The Type of Agency/Jurisdiction filter keeps City / Town. The Category filter keeps Capital markets advisory services.

Overall, counties were less interested in financial and capital markets services than average: 14 percent of counties said they would engage technical assistance if provided by a public cooperative bank; 14 percent of counties said they would engage financial advisory services if provided by a public cooperative bank. The average Likert scale score for cash flow management was 1.67 and the average Likert scale score for depository services was 1.84, which were both markedly lower than the overall averages. Figure B12 shows the level of interest among counties in technical assistance. Figure B13 shows the level of interest among counties in financial advisory services. Figure B14 shows the level of interest among counties in capital markets advisory services.

Figure B12: Technical Assistance – Counties

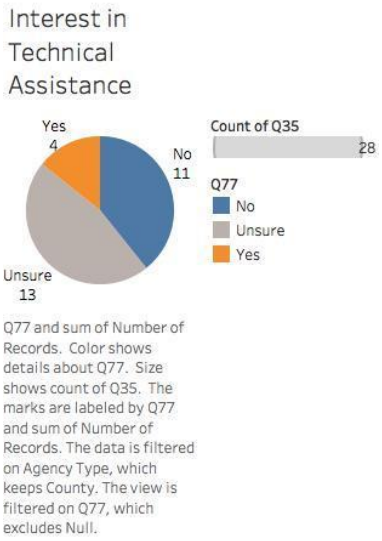


Figure B13: Financial Advisory Services – Counties

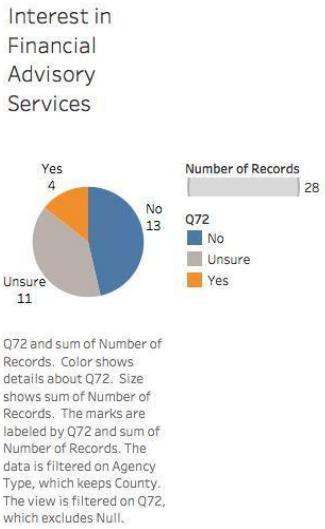


Figure B14: Capital Markets Advisory Services – Counties



Gantt Percent and average of Score for each Question broken down by Category and Type of Agency/Jurisdiction. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The view is filtered on Answer, Type of Agency/Jurisdiction and Category. The Answer filter excludes Null. The Type of Agency/Jurisdiction filter keeps County. The Category filter keeps Capital markets advisory services.

Overall, public utility districts were in line with the average in their interest in financial and capital markets services: 27 percent of public utility districts said they would engage technical assistance if provided by a public cooperative bank; 18 percent of public utility districts said they would engage financial advisory services if provided by a public cooperative bank. The average Likert scale score for cash flow management was 2.30 and the average Likert scale score for depository services was 2.60, both of which were slightly higher than the overall averages. Figure B15 shows the level of interest among public utility districts in technical assistance. Figure B16 shows the level of interest among public utility districts in financial advisory services. Figure B17 shows the level of interest among public utility districts in capital markets advisory services.

Figure B15: Technical Assistance – Public Utility Districts

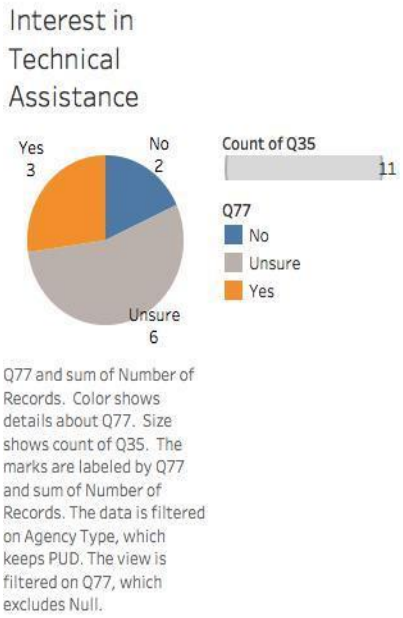


Figure B16: Financial Advisory Services –Public Utility Districts

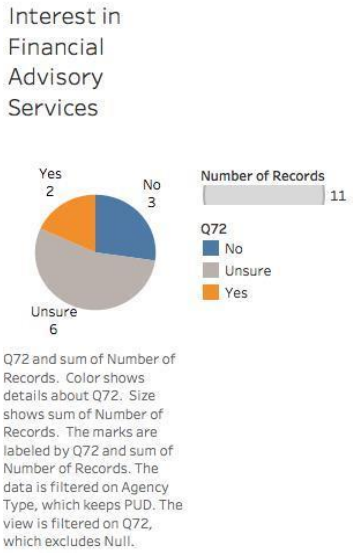


Figure B17: Capital Markets Advisory Services – Public Utility Districts



Gantt Percent and average of Score for each Question broken down by Category and Type of Agency/Jurisdiction. For pane Gantt Percent: Color shows details about Answer. Size shows Percent of Total Sizing. The view is filtered on Answer, Type of Agency/Jurisdiction and Category. The Answer filter excludes Null. The Type of Agency/Jurisdiction filter keeps PUD. The Category filter keeps Capital markets advisory services.

Overall, water/sewer districts were in line with the average in their interest in capital markets advisory services: 29 percent of water/sewer districts said they would engage technical assistance if provided by a public cooperative bank; 46 percent of water/sewer districts said they would engage financial advisory services if provided by a public cooperative bank. The average Likert scale score for cash flow management was 2.15, which was about the same as the overall average score. However, the Likert scale score for depository services was 3.15 was above the neutral level of 3, indicating a slight majority are interested obtaining depository services through a public cooperative bank. Notably, water/sewer districts were the only agencies that expressed a higher than neutral interest in receiving depository services from public cooperative state bank. Figure B18 shows water/sewer districts' level of interest in technical assistance. Figure B19 shows water/sewer districts' interest in financial advisory services. Figure B20 shows water/sewer districts' interest in capital markets advisory services.

Figure B18: Technical Assistance – Water/Sewer Districts

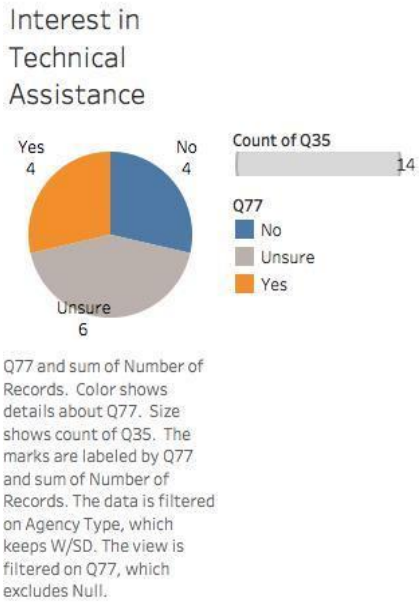


Figure B19: Financial Advisory Services – Water/Sewer Districts

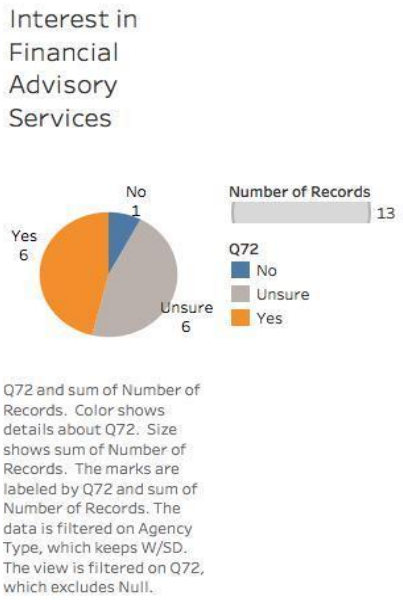


Figure B20: Capital Markets Advisory Services – Water/Sewer Districts



Investment Advisory Services

Overwhelmingly, agencies/jurisdictions across the state rely on the Washington State Local Government Investment Pool (LGIP) for investment management. To a lesser extent, agencies/jurisdictions use both LGIP and either a commercial bank or their County Treasurer. A much smaller minority rely exclusively on a bank or their County Treasurer.

Safety and environmental/social governance were far and above the most important factors agencies/jurisdictions consider when deciding where to place short-term investments. Agencies and jurisdictions also consider – to a much lesser extent – liquidity, supporting the local/regional economy, and maximizing high returns with low fees.

Overall, cities and towns are heavily reliant on LGIP for investment management: 83 percent of cities/towns use LGIP alone or in some combination with bank and/or County Treasurer investment management services: the remaining cities/towns use banks or their County Treasurer exclusively.

Counties are heavily reliant on LGIP for investment management: 70 percent of counties use LGIP in combination with the County Treasurer or Washington State Treasurer; 35 percent use the County Treasurer exclusively, and 5 percent use the Washington State Treasurer exclusively.

Public utility districts are heavily reliant on LGIP for investment management: 67 percent of public utility districts use LGIP alone or in combination with the County Treasurer, Washington State Treasurer, or commercial banks.

Water/sewer districts are reliant on LGIP for investment management, though to a lesser extent than other agencies/jurisdictions: 58 percent of water/sewer districts use LGIP alone or in combination with another investment manager, while 42 percent of water/sewer districts use their County Treasurer exclusively.

Appendix C: Focus Group Questions

1) What products/services do you offer local governments? State agencies? Which of those services do you consider important and successful to your business, and why?

2) What are the biggest barriers to building successful relationships with local governments/state agencies? What suggestions do you have to eliminate barriers?

3) In your view, do local governments/state agencies have adequate access to capital (loans and bond funding) for infrastructure investments? If not, why not? What solutions could financial institutions offer?

4) In your view, do local governments/state agencies have adequate access to investment advisory services? If not, why not? What solutions could financial institutions offer?

5) In your view, do local governments/state agencies have adequate access to treasury management/depository services? If not, why not? What solutions could financial institutions offer?

6) Membership in a state public cooperative bank would be restricted to state agencies and political subdivisions. Its structure would be similar to that of the Federal Home Loan Banks.

- What are your competitive concerns?
- Do you see opportunities for collaboration?

7) Do you have other thoughts about advantages/disadvantages of a state public cooperative bank?

Appendix D: Key Components of an Authorizing Statute

There are numerous things to consider when drafting a statute creating a new governmental instrumentality. This Appendix provides a list of the types of elements that might be appropriate for inclusion in a statute authorizing the formation of an intergovernmental public cooperative bank. A major purpose in listing topics for such a statute, and drafting decisions that must be made, is to create discussion about what's *missing* from the list, *i.e.*, what else needs to be covered, or what other options might there be.

In developing the outline below, the following statutes were consulted as examples:

- Chap. 39.44 RCW (Interlocal Cooperation Act)
- Chap. 43.44A (State Investment Board)
- Chap. 43.52 (Joint Operating Agencies)
- Chap. 43.180 (Washington State Housing Finance Commission
- Chap. 54.44 RCW (Joint Development of Electric Generating Power Facilities)
- Chap. 39.64 RCW ("Taxing District Relief," *i.e.*, bankruptcy
- 12 U.S.C. Chap. 11 (Federal Home Loan Banks)

The following is an outline of potential sections or topics of an authorizing statute, together with questions that might be raised in connection with some of those topics.

1. Declaration & Purpose
2. Definitions (This is critical. For example, a broad definition of "public agencies" that could become members and/or borrowers, such as the definition in RCW 39.34.020(1).)[68]
3. Creation of the public cooperative bank – Qualifications for membership. Formed directly by the Legislature as a State agency and instrumentality, or formed as a State instrumentality under a statute allowing the State (acting through the Governor? The State Finance Committee?) to issue a charter.
4. Governance – Board of Directors
5. Treasurer & Auditor roles; treasury & audit mechanism
6. Powers (for examples of grants of corporate powers, see RCW 43.180.050 and RCW 43.52.300). Corporate and substantive authority might include powers to:
    a. Contract
    b. Establish funds & accounts
    c. Establish reserves
    d. Invest assets
    e. Acquire interests in tangible and intangible property
    f. Borrow money/issue obligations
    g. Provide financial advisory services to local governments

[68] The Interlocal Cooperation Act, at RCW 39.34.020(1), broadly defines a public agency as follows: "(1) 'Public agency' means any agency, political subdivision, or unit of local government of this state including, but not limited to, municipal corporations, quasi municipal corporations, special purpose districts, and local service districts; any agency of the state government; any agency of the United States; any Indian tribe recognized as such by the federal government; and any political subdivision of another state."

h. Sue and be sued in its own name
i. Form or participate in the formation of LLCs, limited partnerships, general partnerships in which the Bank is the general partner or manager
j. Hire and terminate employees (are employees State employees subject to all the usual protections?)
k. Employ, contract with, engage and delegate to advisors, fund managers, attorneys, etc. (See RCW 43.33A.035 and RCW 43.180)
l. Make such expenditures as are reasonably necessary to carry out its responsibilities and programs
m. Conduct investigations and feasibility studies as the board deems appropriate
n. Make loans to members (or to a broader category of "public agencies"?) and determine the terms and conditions of those loans, including charging processing fees as well as interest
o. Modify loan terms, consistent with policies adopted by the Bank's board
p. Types of permissible security for loans, *i.e.*, general obligations, revenue obligations, and/or security interests in land, property, intangible assets
q. Accept, and enforce, instruments evidencing loans and providing security for those loans
r. Calculate and distribute excess revenues to members
s. Receive contributions and grants from any source unless otherwise prohibited
t. Take advantage of Federal Reserve Bank payment systems and account services
u. Exercise any other powers reasonably required to implement the purposes of the public cooperative bank
v. Other

7. Authorization of members and others to contribute to the Bank's capital
8. Authorization of capital contributions from non-members
9. Authorization of borrowing governments to grant property interests to and create liens in favor of the public cooperative bank
10. Authorization of state and local entities to invest in the Bank's obligations (if any)
11. Authority for Member or borrower cross-collateralization (if desired)
12. Authorization of public cooperative bank to join or use services of a Federal Reserve Bank
13. Authority to adopt policies, bylaws and rules
14. Possible limitations on public cooperative bank, its officers, employees and members
    a. No losses to members in excess of capital contributions, as with joint power facilities authorized in Chap. 54.44 RCW
    b. No guarantees of private persons, and no investment in stocks or bonds of private persons
    c. Limits on purposes of loans, *i.e.*, limited to infrastructure? Certain types of infrastructure?
    d. Limits on loan/funded project size
    e. Requirements regarding availability of loans to smaller governments
    f. Require that board members recuse from specific lending decisions affecting entities with which they are employed or are affiliated
    g. Provide liability protection to board members (See RCW 43.33A.070)
    h. No power of eminent domain or taxation (some legislators like to see that—see RCW 43.180.060)

    i. Obligations of the Bank do not constitute obligations or indebtedness of the State of Washington (see RCW 39.94.030(4)(a) and RCW 43.180.030)

15. Procedure in the event of insolvency (*i.e.*, receivership, trusteeship or a bankruptcy process). This could be provided by statutory provision (Chap. 39.64 RCW) making the public cooperative bank subject to the Federal Bankruptcy Code (11 U.S.C. Chap. 9—*see* 11 U.S.C. §109(c) re applicability of the Bankruptcy Code to state instrumentalities). The authorizing statute could also outline a separate insolvency and receivership process such as the one for special purpose districts in Washington State (Chap. 53.48 RCW).
16. Cross-references to other statutes
17. Amendments to other statutes

Appendix E: Fiscal 2018-2019 Budget SBB 6032 Sec. 129(17)

(a) Evaluate the benefits and risks of establishing and operating a state-chartered, cooperative public bank in the state of Washington, specifically including the business and operational issues raised by the 2017 infrastructure and public depository task force; and
(b) Develop a business plan for a public cooperative bank based on the federal home loan bank model whose members may only be the state and/or political subdivisions. The purpose of this bank is to assist the potential members of the bank to manage cash and investments more efficiently to increase yield while maintaining liquidity, and to establish a sustainable funding source of ready capital for infrastructure and economic development in the state of Washington. The business plan shall include, but is not limited to:
    i. Identification of potential members of the bank;
    ii. The capital structure that would be necessary;
    iii. Potential products the bank might offer;
    iv. Projections of earnings;
    v. Recommendations on corporate governance, accountability, and assurances;
    vi. Legal, constitutional, and regulatory issues;
    vii. If needed, how to obtain a federal master account and join the federal reserve;
    viii. Information technology security and cybersecurity;
    ix. Opportunities for collaborating with other financial institutions;
    x. Impacts on the state's debt limit;
    xi. In the event of failure, the risk to taxpayers, including any impact on Washington's bond rating and reputation;
    xii. Potential effects on the budgets and existing state agencies programs; and
    xiii. Other items necessary to establish a state-chartered public cooperative bank modeled after the federal home loan bank or other similar institution.

The office of financial management shall facilitate the timely transmission of information and documents from all appropriate state departments and state agencies to the entity hired to carry out this contract. A status report must be provided to the governor and appropriate committees of the legislature by December 1, 2018, and final report and business plan provided to the appropriate committees of the legislature by June 30, 2019. The contract is exempt from the competitive procurement requirements in chapter 39.26 RCW.